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Annual Report 1976  
Cerro-Marmion  
Corporation

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CERRO-MARMON CORPORATION

1976 ANNUAL REPORT TO SHAREHOLDERS

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To our shareholders:

The year 1976 was a profitable one for Cerro-Marmon Corporation. On a pro forma basis sales were \$908,390,000 and net income amounted to \$45,210,000.

The enclosed financial statements reflect the merger of Cerro Corporation into Cerro-Marmon on February 24, 1976. This business combination has been accounted for as a purchase of Cerro by Cerro-Marmon. For a more complete understanding of these statements we suggest you thoroughly review Notes 1 and 2 under the heading "Notes to Consolidated Financial Statements" beginning on page 12 of this annual report.

In January 1977, Cerro-Marmon acquired all of the outstanding shares of Hammond Corporation. Hammond produces electric organs as well as a line of work and dress gloves. To accomplish this acquisition, GL Corporation contributed 1,648,984 shares of Hammond common stock which it acquired prior to May 1974 at a cost of \$15,933,000. The balance of Hammond's outstanding capital stock was acquired in a cash merger at a cost of \$17,611,000 and Hammond became a wholly-owned subsidiary of Cerro-Marmon.

During 1976, Cerro-Marmon divested itself of a number of operations in line with present management's philosophy of building Cerro-Marmon primarily on its base in metal manufacturing and coal mining. Investments sold were the Zidani Asbestos Mine Project in Greece, the Cerro Spar joint venture mining properties in Kentucky and Tennessee and Northwest Iron Co., Ltd. in Australia.

In 1976 a decision was made to sell the ICX trucking operation. Negotiations have been concluded to sell ICX to a newly created corporation owned by certain ICX salaried employees. Cerro-Marmon will own a 19% interest in the new corporation.

Early in 1977, the debt of Leadership Housing was restructured and certain agreements were modified. As a result, Leadership has become a viable entity that Cerro-Marmon can support financially during the period required for an orderly disposition of certain land inventories and continued operation of the balance.

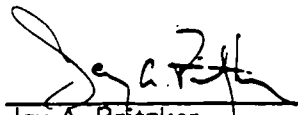
Home office functions were consolidated in the move of the Cerro office from New York to Chicago. Total home office expenses were reduced from \$4,900,000 in 1975 to \$3,000,000 in 1976. This is in accordance with our philosophy of operating with minimum home office overhead and expenses.

We feel that through divestitures, realignments and reorganizations, Cerro-Marmon is now a simpler, more manageable organization which should continue to grow and prosper in the coming year.

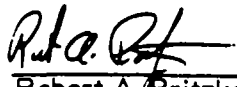
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We would be remiss if we did not take advantage of this opportunity to comment on the high quality of personnel we have found at the various Cerro operating units. We want to thank them and the Marmon people for bearing with us during the difficult times which, it is hoped, are now behind us.



Jay A. Pritzker  
Chairman of the Board



Robert A. Pritzker  
President

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## GENERAL INFORMATION

### Stock Information

Cerro-Marmon's \$2.25 Cumulative Series A Preferred Stock was listed for trading on the American Stock Exchange on February 24, 1976. Sales prices on the American Stock Exchange and dividends paid since February 24, 1976 are as follows:

	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
Sales prices:				
High	\$ 20.38	\$ 21.50	\$ 22.25	\$ 23.63
Low	18.88	19.25	20.00	21.50
Dividends	\$ .2227	\$ .5625	\$ .5625	\$ .5625

### Stock transfer agent

Irving Trust Company  
One Wall Street  
New York, New York 10015  
(212) 487-5742

### Registrar of stock

Bankers Trust Company  
P.O. Box 318  
Church Street Station, New York 10015

### Auditors

Arthur Young & Company  
One IBM Plaza  
Chicago, Illinois 60611

### Annual shareholders' meeting

The annual meeting of Cerro-Marmon Corporation will be held at 10:30 a.m. on June 3, 1977 at the Water Tower Hyatt House, 800 N. Michigan Avenue, Chicago, Illinois Room Promenade A.

### Form 10-K

A copy of the annual report to the Securities and Exchange Commission on Form 10-K may be obtained from the company at no expense to the shareholder. Direct your request to:

Mr. Thomas L. Seifert, Secretary  
Cerro-Marmon Corporation  
39 South LaSalle Street  
Chicago, Illinois 60603

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## BUSINESS DESCRIPTION

Cerro-Marmon Corporation (Cerro-Marmon) was incorporated in Delaware on November 25, 1975 and was inactive until February 24, 1976. On that date, Cerro Corporation (Cerro) merged into Cerro-Marmon pursuant to a Plan of Merger and an Exchange Agreement, each dated January 15, 1976. Pursuant thereto, GL Corporation (GL), a Delaware corporation, exchanged all of the outstanding shares of capital stock of The Marmon Group, Inc. (Michigan) (Marmon) for five million newly issued common shares of Cerro-Marmon.

The former Cerro operations are engaged in the United States in the manufacture and sale of refined copper, copper and brass mill products, electric wire and cable and valves, fittings, regulators and other control equipment for pressurized gases; coal mining; the holding of real estate for sale or development; and common carrier motor freight operations which are to be sold. A wholly-owned subsidiary conducts world wide trading activities in nonferrous refined metals, concentrates and ores including copper, lead, zinc, silver and companion metals. Cerro-Marmon also has a 21.02% interest in Southern Peru Copper Corporation, a company which operates large copper mines in Peru, and various interests in several relatively small mining and manufacturing companies in Peru.

Marmon is a wholly-owned subsidiary of Cerro-Marmon. Marmon was organized on August 26, 1969, and is the successor through merger to a corporation which was organized in 1904. Marmon is engaged, directly and through several subsidiaries, in the distribution of steel pipe and tubing and the manufacture and fabrication of copper and aluminum tubing; the manufacture of products for use principally in the automotive industry; the design and manufacture of equipment used in the mining industry; the manufacture of building products and equipment; and the manufacture of specialized equipment for use principally in the agricultural industry.

Reference is made to the lines of business and pro forma lines of business data which appears on pages 34, 35, 36 and 37 of this report and to Management's Discussion and Analysis of Results of Operations appearing on pages 38 and 39 for more information on the combined results of operations of Cerro-Marmon.

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## REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Shareholders  
Cerro-Marmon Corporation

We have examined the consolidated balance sheets of Cerro-Marmon Corporation (Note 1) at December 31, 1976 and 1975 and the related consolidated statements of income, shareholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have received the reports of other independent accountants on their examinations of the 1976 consolidated financial statements of the trucking subsidiary (Note 8) and the major real estate subsidiary (Leadership) (Note 9). Our opinion expressed herein on the 1976 consolidated financial statements of Cerro-Marmon, insofar as it relates to amounts included in such consolidated financial statements that were derived from the 1976 consolidated financial statements of the trucking subsidiary and Leadership, is based solely on the reports of the other independent accountants.

The report of other independent accountants referred to above on the 1976 consolidated financial statements of Leadership and our report dated April 9, 1976 on the 1975 consolidated financial statements of The Marmon Group, Inc. (Michigan) (the accounting predecessor of Cerro-Marmon) were qualified as to the effects of such adjustments, if any, as might have been required had the outcome of certain specified uncertainties relating to the real estate operations been known. As discussed in Note 3, the partial resolution of these uncertainties in 1976 did not have a material effect upon the accompanying consolidated financial statements of Cerro-Marmon at December 31, 1976 and 1975 and for the years then ended and the resolution of the remaining uncertainties relating to the real estate operations will not have a material effect on such financial statements. Accordingly, our present opinion on the 1975 financial statements, as presented herein, is different from that expressed in our previous report.

As discussed in Note 3 to the consolidated financial statements, the allocation of purchase cost reflected in the consolidated balance sheet at December 31, 1976 and the effects thereof reflected in the consolidated statements of income for 1976 and 1975 are subject to retroactive revision to reflect (1) the realization of income tax benefits from prior year losses of Cerro and (2) the outcome of certain specific matters discussed in Note 3 relating to Leadership and the prior year federal income tax position of Cerro. The effect of such retroactive revisions, if any, cannot be determined at this time. However, as discussed in Note 3 to the consolidated financial statements, any retroactive revisions required will not have a material effect on the 1975 consolidated financial statements or on consolidated working capital and shareholders' equity at

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December 31, 1976, nor will the effects of any such adjustments exceed 10% of reported consolidated net income for 1976.

In our opinion, based on our examinations and the reports of other independent accountants referred to in the first paragraph above, and subject to the effects on the 1976 consolidated financial statements of such retroactive revisions, if any, as may be required to reflect the outcome of the matters referred to in the preceding paragraph, the statements described in the first paragraph above present fairly the consolidated financial position of Cerro-Marmon Corporation at December 31, 1976 and 1975 and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR YOUNG & COMPANY

Chicago, Illinois

April 22, 1977

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CERRO-MARMON CORPORATION  
CONSOLIDATED STATEMENT OF INCOME

(In thousands of dollars)

	Years ended December 31,	
	<u>1976</u>	<u>1975</u>
	(Notes 1, 2 and 3)	
Revenues:		
Net sales	\$828,218	\$275,536
Miscellaneous - net (Note 10)	<u>10,927</u>	<u>1,572</u>
	<u>839,145</u>	<u>277,108</u>
Costs and expenses:		
Cost of sales	703,515	217,790
Selling and administrative	58,455	26,580
Interest	<u>11,342</u>	<u>8,024</u>
	<u>773,312</u>	<u>252,394</u>
Income before amounts shown below	65,833	24,714
Income taxes (Note 15)	<u>28,050</u>	<u>12,855</u>
Income before equity in net income of Cerro Corporation and discontinued business	37,783	11,859
Equity in net income from continuing operations of Cerro Corporation (Note 7)	<u>1,436</u>	<u>10,384</u>
Income from continuing operations	39,219	22,243
Income of discontinued business less income taxes (Note 8)	<u>3,540</u>	<u>2,460</u>
Net income	42,759	24,703
Net income applicable to preferred stock (Note 17)	<u>(9,009)</u>	
Net income applicable to common stock	<u>\$ 33,750</u>	<u>\$ 24,703</u>

See Notes to Consolidated Financial Statements.

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CERRO-MARMON CORPORATION

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 1976 AND 1975  
(In thousands of dollars)

	Preferred Stock (Note 17)	Common Stock (Note 17)	Other Paid-In Capital	Retained Earnings (Note 12)	Total
Balance at January 1, 1975	\$	1	\$ 11,962	\$ 64,590	\$ 76,553
Net income				24,703	24,703
Other - net			65	(435)	(370)
Balance at December 31, 1975		1	12,027	88,858	100,886
Excess of par value of Cerro-Marmon common stock issued to GL over par value of Marmon common stock		4,999	(4,999)		
Value of preferred stock issued and issuable to Cerro shareholders (Note 2)	88,375		2,336		88,375
Contribution by GL (Note 16)					2,336
Elimination of Marmon deferred income taxes applicable to its equity in undistributed net income of Cerro			877	(8,136)	877
Preferred dividends paid					(8,136)
Accrual of redemption value of preferred stock (Note 17)	873			(873)	
Net income				42,759	42,759
Balance at December 31, 1976	\$ 89,248	\$ 5,000	\$ 10,241	\$ 122,608	\$ 227,097

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See Notes to Consolidated Financial Statements.

CERRO-MARMON CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(In thousands of dollars)

	Years ended December 31,	
	<u>1976</u>	<u>1975</u>
Sources of working capital:		
Income from continuing operations	\$ 39,219	\$ 22,243
Charges (credits) not involving working capital -		
Provision in lieu of income taxes	6,030	65
Depreciation, depletion and amortization	9,460	5,386
Equity in undistributed net income from continuing operations of Cerro Corporation	(786)	(6,271)
Other - net	2,276	739
Total from continuing operations	<u>56,199</u>	<u>22,162</u>
Income of discontinued business - net	3,540	2,460
Charge (credits) not involving working capital -		
Provision in lieu of income taxes	1,367	
Equity in undistributed net income of discontinued business	(2,886)	(2,460)
Total from discontinued operations	<u>2,021</u>	<u>        </u>
Total from operations	<u>58,220</u>	<u>22,162</u>
Merger of Cerro Corporation at February 24, 1976 -		
Preferred stock issued and issuable	\$ 88,375	
Marmon's basis in 45.33% of Cerro	80,028	
Long-term obligations assumed	84,104	
Other - net	18,248	
	<u>270,755</u>	
Less cost assigned to non-current assets:		
Trucking subsidiary	14,444	
Real estate subsidiaries	14,944	
Notes due from Chile	15,087	
Property, plant and equipment - net	59,438	
Other non-current assets	4,507	
	<u>108,420</u>	
Total from merger of Cerro Corporation	162,335	
Reduction in long-term portion of notes due from Chile	12,669	
Long-term borrowings	8,160	1,900
Sale of investments	1,369	
Disposition of property, plant and equipment	<u>3,764</u>	<u>1,771</u>
Total	<u>246,517</u>	<u>25,833</u>

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## Disposition of working capital:

Investment in Southern Peru Copper Corporation	5,450	
Additional investment in and advances to real estate subsidiaries - net	5,091	
Purchase of property, plant and equipment	17,657	7,245
Reduction in long-term obligations	76,513	5,106
Preferred dividends paid	8,136	
Other - net	966	(410)
Total	<u>113,813</u>	<u>11,941</u>
Increase in working capital	<u>\$132,704</u>	<u>\$ 13,892</u>

## Changes in Elements of Working Capital

## Increase (decrease) in current assets:

Cash, deposits and marketable securities	\$ 72,676	\$ 1,657
Receivables	74,830	979
Inventories	151,339	(4,317)
Other current assets	5,371	(237)
	<u>304,216</u>	<u>(1,918)</u>

## (Increase) decrease in current liabilities:

Notes payable to banks	(37,480)	8,000
Notes payable to affiliates	(3,000)	
Long-term obligations due within one year	(6,914)	(3,189)
Accounts payable	(81,515)	9,974
Income taxes	(19,683)	519
Accrued liabilities	(22,920)	506
Increase in working capital	<u>\$132,704</u>	<u>\$ 13,892</u>

See Notes to Consolidated Financial Statements.

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CERRO-MARMON CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1976 and 1975

(Tabular amounts are in thousands of dollars, except as noted)

1. Organization and Basis of the Financial Statements

Cerro-Marmon Corporation (Cerro-Marmon), incorporated on November 25, 1975, was inactive until February 24, 1976. On that date (1) Cerro-Marmon issued 5 million common shares to GL Corporation (GL) for all of the outstanding common shares of The Marmon Group, Inc. (Michigan) (Marmon), in a transaction accounted for as if it was a pooling of interests, (2) Cerro-Marmon became obligated to issue preferred stock to holders of Cerro Corporation (Cerro) common stock, other than Marmon, on a share-for-share basis and (3) Cerro was merged into Cerro-Marmon in a transaction accounted for as a purchase. Cerro common stock owned by Marmon, representing 45.33% of the Cerro common stock outstanding, was cancelled. As a result of the above described transactions, GL owns 100% of the outstanding Cerro-Marmon common stock, which represents approximately 82% of the total voting interest in Cerro-Marmon, and Marmon is a wholly-owned subsidiary of Cerro-Marmon.

The consolidated financial statements for periods prior to February 25, 1976 consist of the consolidated financial statements of Marmon (Cerro-Marmon's accounting predecessor company) and all subsidiaries, with Marmon's 45.33% interest in Cerro accounted for on an equity basis. Commencing February 25, 1976, the consolidated financial statements consist of the financial statements of Cerro-Marmon and all significant subsidiaries except the real estate subsidiaries (Notes 2 and 9) and the trucking subsidiary which is to be sold (Note 8).

2. Acquisition of Cerro

Effective August 1, 1974, Marmon acquired 3,586,297 common shares of Cerro, a 45.33% equity interest, at a total cost of \$67,846,000. Of the shares acquired, 813,100 shares were acquired from GL at GL's cost of \$14,031,000 and the remaining shares were acquired pursuant to a cash tender offer. The shares acquired from GL were purchased by GL principally in the period February-May 1974.

On February 24, 1976, Cerro was merged into Cerro-Marmon (Note 1). Pursuant thereto, the former common shareholders of Cerro, other than Marmon, became entitled to receive one share of Cerro-Marmon \$2.25 Cumulative Series A Preferred Stock (Note 17) for each share of Cerro common stock. Accordingly, the holders of a total of 4,324,970 common shares of Cerro were entitled to receive a like number of preferred shares. Of this number of shares, shareholders owning 65,913 shares have received or will receive cash for their shares. The preferred shares were valued by the Board of Directors of Cerro-Marmon at \$20.75 per share, based on the estimated fair value of the preferred stock determined when the exchange ratio was approved by the Board of Directors of Cerro. A value of \$19 per share has been assigned to the Cerro shares to be acquired for cash (Notes 16 and 17).

The above described transactions have been accounted for as a purchase of Cerro by Cerro-Marmon. Accordingly, the net assets of the businesses formerly conducted by Cerro are included in the consolidated balance sheet of Cerro-Marmon at amounts determined after giving effect to an allocation of Cerro-Marmon's purchase cost to such net assets.

The amount at which Cerro's net assets at February 24, 1976 were included in the Cerro-Marmon balance sheet at that date was determined as follows:

Applicable to 45.33% interest -

Cost to Marmon	\$ 67,846
Equity in Cerro's undistributed net income	<u>12,182</u>
Marmon's basis in 45.33% of Cerro at February 24, 1976	\$ 80,028

Applicable to 54.67% interest -

Value of preferred stock issuable	88,375
Cerro common stock to be acquired for cash	<u>1,253</u>
Acquisition costs	<u>2,295</u>
Cerro-Marmon's cost of 54.67% of Cerro	91,923
Proposed litigation settlement cost to be paid by GL (Note 16)	<u>2,336</u>
Cerro-Marmon's basis in net assets of Cerro at February 24, 1976	<u>\$ 174,287</u>

Summarized information follows as to Cerro's net assets at December 31, 1975 and February 24, 1976 (unaudited) and the amounts at which Cerro's net assets at February 24, 1976 were included in the Cerro-Marmon balance sheet at that date after making the purchase cost allocations discussed below.

	Cerro At December 31, 1975	Cerro At February 24, 1976	Cerro-Marmon At February 24, 1976
	(In millions of dollars)		
Current assets	\$ 301.9	\$ 308.3	\$ 308.3
Current liabilities	<u>141.3</u>	<u>142.4</u>	<u>142.4</u>
Working capital	160.6	165.9	165.9
Trucking subsidiary	28.1	28.9	14.4
Real estate subsidiaries	34.7	34.6	14.9
Notes due from Chile	13.2	12.0	15.1
Future income tax benefit	41.4	37.8	
Investments and other assets	16.7	16.1	2.8
Property, plant and equipment	136.3	135.4	59.4
Intangibles	<u>5.0</u>	<u>4.9</u>	<u>1.8</u>
	436.0	435.6	274.3
Less:			
Long-term obligations	89.3	86.3	84.1
Deferred credit from acquisition			4.1
Other non-current amounts	<u>5.5</u>	<u>7.5</u>	<u>11.8</u>
Net assets	<u>\$ 341.2</u>	<u>\$ 341.8</u>	<u>\$ 174.3</u>

The allocations of purchase cost to Cerro's net assets were made as of August 1, 1974 as to the 45.33% interest in Cerro acquired as of that date and as of February 24, 1976 as to the 54.67% interest in Cerro acquired as of that date. The initial tentative allocations of purchase cost, as reported in the Cerro-Marmon report to shareholders for the first quarter of 1976, have been revised to reflect additional information obtained subsequently, including the substantial resolution of various uncertainties relating to the real estate operations and the amount of proceeds received or to be received from the dispositions of certain assets and operations. The effect of the purchase cost allocations was to significantly reduce the amounts at which Cerro's net assets are included in the Cerro-Marmon consolidated balance sheet from amounts previously reflected in Cerro's historical consolidated balance sheet. Reductions were made principally to investments (including the investment in the real estate subsidiaries), property, plant and equipment, intangible assets and the asset included in the Cerro balance sheet for future income tax benefit. The purchase cost

allocation shown above and the effects thereof on results of operations discussed below are subject to retroactive revision to reflect the resolution of certain specific matters as discussed in Note 3.

The purchase cost allocations had the effect of significantly increasing the amount reflected by Marmon as its equity in the net income of Cerro prior to February 25, 1976 and the net income of Cerro-Marmon subsequent thereto. This effect results principally from (1) reductions in depreciation, depletion and amortization of property, plant and equipment and intangible assets, (2) larger gains or lesser losses from dispositions of assets and (3) elimination of net losses from the real estate operations for periods through December 31, 1976, as discussed in the following paragraph.

For purposes of determining Marmon's equity in Cerro's net income prior to February 25, 1976 and Cerro-Marmon's results of operations from February 25 to December 31, 1976, the net losses of the nonconsolidated real estate subsidiaries were charged to a reserve established therefore in connection with the purchase cost allocations because significant uncertainties precluded an allocation of purchase cost to the net assets of these subsidiaries at the dates of purchase. As discussed more fully in Note 9, various of the uncertainties as to the real estate operations were substantially resolved as of December 31, 1976 and a purchase cost allocation was made; therefore, the results of operations of the real estate subsidiaries will be reflected in consolidated net income beginning January 1, 1977.

Had the merger of Cerro into Cerro-Marmon been consummated on January 1, 1975, the pro forma revenue and net income for 1976 and 1975 would have been as follows:

	<u>1976</u>	<u>1975</u>
	(Unaudited)	
Revenues	<u>\$ 921,323</u>	<u>\$ 767,331</u>
Income from continuing operations	\$ 41,624	\$ 35,170
Income from discontinued business	<u>3,586</u>	<u>3,428</u>
Net income	<u>\$ 45,210</u>	<u>\$ 38,598</u>

The above pro forma amounts consist of the historical amounts applicable to Marmon and Cerro for the year 1975 and the period January 1, 1976 to February 24, 1976, all adjusted on a pro forma basis to give effect to the adjustments resulting from the merger of Cerro into Cerro-Marmon, and the reported amounts applicable to Cerro-Marmon for the period subsequent to the merger date, both adjusted to reflect the discontinuance of trucking operations. As noted above, no amounts are included for the real estate subsidiaries. See Note 19 for data as to the acquisition of Hammond Corporation in January 1977.

### 3. Uncertainties

Significant uncertainties relating to the former Cerro operations existed at December 31, 1975 and February 24, 1976. Such uncertainties related principally to the real estate operations (Leadership) and, as a result thereof, to the realizable value of Cerro's asset "Future income tax benefit". As discussed in Note 9, various of the uncertainties relating to the real estate operations have been substantially resolved, with the major remaining uncertainty relating to the ultimate liability that may result from a guarantee by Leadership of debt of a joint venture in which Leadership participates. Such resolution had no material effect on the consolidated financial statements of Cerro-Marmon and the resolution of the remaining uncertainties will have no material effect on such financial statements. Further, no purchase cost was allocated to Cerro's asset, "Future income tax benefit", which is being accounted for as realized as discussed in the following paragraph.

Income tax matters, including matters relating to Cerro's prior year federal income tax position, are discussed in Note 15. On the basis of presently known information, management of Cerro-Marmon does not anticipate any significant change in the prior year federal income tax position of Cerro from that reflected on Cerro's income tax returns other than as provided for. Further, Cerro-Marmon's management anticipates that the amount of future income tax benefit available from Cerro's prior year losses will be ultimately realized. However, because of the complexities of the matters and because no member of Cerro-Marmon's management was a part of Cerro management prior to 1975, Cerro-Marmon will continue to include all income tax benefits realized from prior year losses of Cerro in the "Deferred credit from acquisition" in the Cerro-Marmon consolidated balance sheet (rather than being partially applied to reduce the purchase cost allocated to Cerro's former property, plant and equipment) and to reflect no amortization of the deferred credit in income until the matters referred to above, including the matter relating to Leadership, are resolved. The effect thereof on the 1976 consolidated financial statements was not material. Upon resolution, the purchase cost allocated to Cerro's net assets will be retroactively revised to reflect any adjustments resulting from (1) the realization of income tax benefits from prior year losses of Cerro and (2) the outcome of the matters discussed above relating to Leadership and the prior year federal income tax position of Cerro. Further, provisions for depreciation and depletion will be retroactively adjusted to reflect the effects of any revision of purchase cost allocated to property, plant and equipment and amortization of any deferred credit will be retroactively included in income. Any retroactive adjustments required will not have a material effect on the 1975 consolidated financial statements or consolidated working capital and shareholders' equity at December 31, 1976, nor will the effects of any such adjustments exceed 10% of reported consolidated net income for 1976.

#### 4. Summary of Accounting Policies

The significant accounting policies of Cerro-Marmon are as follows:

##### (A) Consolidation policy

The consolidated financial statements include the accounts of all significant subsidiaries except the real estate subsidiaries (Notes 2 and 9) and the trucking subsidiary to be sold (Note 8). See Note 1 for the basis of the consolidated financial statements. All significant intercompany balances and transactions have been eliminated.

##### (B) Inventories

Inventories, other than metal trading inventories, are valued at the lower of cost or market. The cost of inventories comprising 22% and 82% of consolidated inventories in 1976 and 1975, respectively, is determined under the last-in, first-out (LIFO) method. Cost of the remaining inventories, other than metal trading inventories, represents current cost (standard, average or first-in, first-out).

Metal trading inventories and open positions (outstanding futures contracts, unfulfilled physical purchase and sale commitments and related foreign currency commitments) are valued at market and the resultant gain or loss is reflected in results of operations.

##### (C) Investments

Investments in marketable securities are carried at the lower of cost or market.

The investment in the real estate subsidiaries is carried at cost to Cerro-Marmon, which will be adjusted beginning January 1, 1977 for Cerro-Marmon's equity in the subsidiaries' net income or loss (Notes 2 and 9).

The investment in the trucking subsidiary, which is to be sold, is carried at Cerro-Marmon's cost, adjusted for Cerro-Marmon's equity in the subsidiary's undistributed net income subsequent to dates of acquisition (Note 8).

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The investment in Cerro was accounted for by Marmon on the equity method through February 24, 1976. Marmon's equity in Cerro's reported net income was adjusted to reflect the effects of the differences between Marmon's cost and its equity in the net assets of Cerro at August 1, 1974, the date of acquisition by Marmon of its 45.33% interest in Cerro.

Other investments, including investments in affiliated companies, principally Southern Peru Copper Corporation (SPCC) (Note 10), a 21.02% owned affiliate, are carried at cost or less. Income is recognized only upon receipt of dividends. The cost method is used for the investment in SPCC because it is domiciled in a country with significant foreign exchange restrictions. The other affiliates are not significant.

(D) Property, Plant and Equipment

Property, plant and equipment are recorded at cost to Cerro-Marmon, less accumulated depreciation and depletion. Gain or loss on sales or retirements is included in earnings. Maintenance and repairs are expensed; renewals and betterments are capitalized. Depreciation is based on the estimated service lives of the assets using primarily accelerated methods. Depletion of mining properties is based on the units-of-production method.

(E) Income Taxes

Deferred taxes are provided to account for the differences for accounting and tax purposes in the timing of the recognition of certain income and expense items. These differences consist principally of allowances for losses and accrued expenses not yet deductible for income tax purposes, gains from certain metal trading activities not yet taxable and, in 1975, the equity in the undistributed net income of Cerro as to which deferred income taxes were provided on the basis that the undistributed earnings would be received as a dividend and subject to the statutory dividend exclusion.

Investment tax credits are accounted for as reductions of the current provision for U.S. income taxes as such credits are earned.

(F) Retirement Plans

Pension costs, actuarially determined and generally funded as accrued, consist of current service costs, interest on unfunded past service liabilities and amortization of prior service costs over periods not exceeding 40 years. Profit sharing plan costs are recorded in amounts approved by the Board of Directors as contributions to the profit sharing plan trusts.

5. Notes Due from Chile

In connection with the 1971 expropriation of a Chilean mining company, formerly 70% owned by Cerro, the Government of Chile issued 9.165% Series A and B Notes, payable \$2,700,000 semi-annually including interest, which are exempt from Chilean taxes and guaranteed by the Central Bank of Chile. An agency of the United States government has guaranteed the payment of a portion of the principal amount of the Series B Notes and the interest thereon (\$3,100,000 as of December 31, 1976).

The principal amount of notes outstanding at December 31, 1976 of \$10,400,000 exceeds Cerro-Marmon's carrying value by \$1,900,000. This amount is being reflected in earnings over the remaining scheduled collection period (to March 1, 1979).

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## 6. Inventories

	December 31,	
	1976	1975
Metal trading inventories	\$ 63,326	
Coal inventories and supplies	9,424	
Manufacturing inventories and supplies	<u>129,370</u>	<u>\$ 50,781</u>
	<u>\$ 202,120</u>	<u>\$ 50,781</u>

Inventories valued under the LIFO method were approximately \$27,200,000 less than the current costs of such inventories at December 31, 1976 (\$25,300,000 at December 31, 1975). Reductions in the levels of certain inventories carried at LIFO costs, which were less than current costs, increased net income by approximately \$600,000 in 1976 (\$1,000,000 in 1975). The classification of manufacturing inventories by stage of production is not available from the accounting records.

Cerro-Marmon entered into certain arrangements for the future delivery of copper in December 1976 and approximately \$50,000,000 was received as advance payments on these sales. For financial statement purposes, these advanced copper sales are not reflected as sales until the copper is delivered and Cerro-Marmon's obligation is satisfied. The cash received as advance payments was temporarily invested and is included in "Time and certificates of deposit" in the consolidated balance sheet and the liability for the cost of the copper to be delivered is included in "Accounts payable". See Note 15 for the income tax treatment of these advance payments.

## 7. Investment in Cerro Corporation

Effective August 1, 1974, Marmon acquired 3,586,297 common shares of Cerro, representing 45.33% of the outstanding common shares of Cerro at that date, for a total cost of \$67,846,000. The Cerro stock held by Marmon was cancelled on February 24, 1976 in connection with the merger of Cerro into Cerro-Marmon (Note 1).

Summarized information as to Cerro's net assets at December 31, 1975 and February 24, 1976 is presented in Note 2. Marmon's equity in the net income of Cerro for the year ended December 31, 1975 and the period January 1 to February 24, 1976 was determined as follows:

	Period Jan. 1 to Feb. 24, 1976	Year ended Dec. 31, 1975
Marmon's equity (45.33%) in the reported net income (loss) of Cerro	\$ 921	\$ (1,092)
Adjustments to reflect the effects of the allocation of Marmon's purchase cost of the Cerro stock to Marmon's proportionate interest in Cerro's net assets at August 1, 1974 as discussed in Note 2:		
Reduction in depreciation and amortization of Cerro's property, plant and equipment and intangible assets	652	4,212
Elimination of the net loss from real estate operations	353	9,604
Other - net	<u>(144)</u>	<u>310</u>
Marmon's equity in Cerro's net income, as adjusted	<u>\$ 1,782</u>	<u>\$ 13,034</u>

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Marmon's equity in Cerro's net income is presented in the consolidated statement of income as follows:

Continuing operations	\$ 1,436	\$ 10,384
Discontinued business	<u>346</u>	<u>2,650</u>
	<u>\$ 1,782</u>	<u>\$ 13,034</u>
Dividends received from Cerro	<u>\$ 650</u>	<u>\$ 4,303</u>

As discussed in Note 2, the net losses from the real estate operations were eliminated from Marmon's equity in the net income of Cerro by charges to a reserve established therefore in connection with the purchase cost allocation. The method used to determine the amounts charged to such reserve by Marmon prior to February 25, 1976 differed from the method used by Cerro-Marmon subsequent thereto but the result determined by Marmon was substantially identical to the result obtained by use of the Cerro-Marmon method.

Revenues of Cerro, after restatement for the discontinued trucking business and the real estate subsidiaries, were \$489,772,000 in 1975 and \$82,151,000 in the period January 1 to February 24, 1976.

#### 8. Investment in Trucking Subsidiary

Cerro-Marmon intends to sell its majority-owned trucking subsidiary, ICX Industries, Inc., to ICX Corporation, a corporation formed by certain employees of the trucking subsidiary, for approximately \$22,600,000 in cash, a subordinated note of approximately \$5,500,000 (subject to changes in net asset value of the subsidiary to date of sale), which bears interest at prime plus 4½% per annum, and a 19.8% equity interest in ICX Corporation. Such sale is expected to be completed in June 1977. Accordingly, the trucking subsidiary is reflected in the financial statements as a discontinued business. The gain to be realized on the sale, before income taxes, is estimated at approximately \$5 million based on the cash proceeds to be received. The gain represented by the notes and stock will be reflected as amounts are realized in cash.

Net assets applicable to the discontinued trucking operations, after giving effect to Cerro-Marmon's purchase cost allocations, at December 31, 1976 follow:

Current assets	\$ 8,078
Current liabilities	<u>7,535</u>
Net current assets	543
Property and equipment - net	13,743
Operating rights and other assets	6,183
Non-current obligations	<u>(3,460)</u>
Net assets	<u>\$ 17,009</u>

The amounts shown in the consolidated statement of income as income of discontinued business for periods prior to February 25, 1976 consist of Marmon's 45.33% equity in the net income of Cerro's trucking subsidiary, less Marmon's income taxes relating thereto, and for the period February 25 to December 31, 1976 consists of the adjusted income of the trucking subsidiary, less related income taxes (Note 15).

For the period February 24, 1976 through December 31, 1976, ICX Industries, Inc. reported revenues of \$71,126,000.

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## 9. Investment in Real Estate Subsidiaries

The nonconsolidated real estate subsidiaries consist of Leadership Housing, Inc. (Leadership) and The Housing Group, Inc. (Housing Group) and their subsidiaries. Housing Group was formed during 1976 by the transfer of certain assets from Leadership. Amounts relating to the real estate subsidiaries at December 31, 1976 consist of the following:

Advances	\$ 19,493
Investment	<u>542</u>
Total	<u>\$ 20,035</u>

The above amounts represent the results of the allocation of the purchase cost of Cerro to the real estate subsidiaries. The amount shown as investment is equal to the stockholder's equity shown in the subsidiaries' balance sheets as of December 31, 1976, reduced to reflect the effects of the purchase cost allocation to the net assets of these subsidiaries.

No amounts have been included in the consolidated results of operations applicable to the real estate subsidiaries as the loss incurred by these subsidiaries was charged to a reserve established for such purpose by the initial purchase cost allocations. This reserve was established because various uncertainties relating to the real estate operations precluded an allocation of purchase cost to the real estate assets at the dates of acquisition of Cerro. Certain of these uncertainties were substantially resolved by the modification of certain agreements and restructuring of debt obligations concluded in February 1977, the reductions in inventories and the restructuring of the activities of the real estate subsidiaries, and the general improvement in the market in the various areas in which the real estate operations are conducted. Uncertainties remaining are discussed elsewhere in this note. The most significant remaining uncertainty relates to the guarantee of debt of a joint venture in which Leadership is a participant (See B in this Note). The above described events permitted a quasi-reorganization of Leadership as of December 31, 1976 at which date its assets were revalued to reflect their fair market values. These revised asset values were used as the basis for finalizing the purchase cost allocation to the real estate assets and to Cerro-Marmon's investment in the real estate subsidiaries. Commencing January 1, 1977, Cerro-Marmon will reflect its equity in the net income or loss of the real estate subsidiaries in the consolidated financial statements.

For the year ended December 31, 1976, the real estate subsidiaries reported a loss before income taxes of \$18,336,000 on sales of \$56,836,000. This loss, which is based on the historical financial statements of the real estate subsidiaries before giving any effect to purchase cost allocations, was charged to the reserve established therefore as discussed above.

A condensed pro forma combined balance sheet of the real estate subsidiaries at December 31, 1976, after giving effect to the above-mentioned quasi-reorganization of Leadership, modification of certain agreements and restructuring of debt obligations completed in 1977, and after reflecting the purchase cost adjustments to the real estate subsidiaries' net assets, follows:

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Real Estate Subsidiaries  
Condensed Pro Forma Combined Balance Sheet  
December 31, 1976

**ASSETS:**

Cash	\$ 4,413
Receivables	8,329
Inventories (A)	71,806
Investment in joint ventures (B)	1,530
Property and equipment - net	2,204
Other assets (C)	<u>4,249</u>
	92,531

**LESS:**

Notes payable (D)	\$ 54,250
Accounts payable and accrued liabilities	<u>18,246</u>

72,496

Cerro-Marmon's equity and advances \$ 20,035

**(A) Inventories**

Inventories are carried at the lower of cost or estimated net realizable value, which amount approximates fair market values at December 31, 1976. The estimated net realizable values have been determined based on dispositions in the normal course of business under existing and anticipated market conditions.

The inventories at December 31, 1976 consist of:

Land and land improvement costs	\$ 53,460
Developments completed or in progress	<u>18,346</u>
	<u><u>\$ 71,806</u></u>

**(B) Investment in Joint Ventures**

The investment at December 31, 1976 consists of:

Notes receivable	\$ 4,247
Notes payable	(2,722)
Equity	4,480
Reduction for effect of reduced income tax basis	<u>(4,475)</u>
	<u><u>\$ 1,530</u></u>

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The equity investment shown above represents the estimated fair value of Leadership's equity in the underlying net assets of the joint ventures. These net assets are summarized as follows:

Receivables	\$ 12,855
Inventories	84,761
Other assets	<u>3,905</u>
	101,521
Notes and mortgages payable	\$ 72,623
Other liabilities	<u>6,600</u>
	<u>79,223</u>
	<u>\$ 22,298</u>
Equity -	
Leadership	4,480
Venture partners	<u>17,818</u>
	<u>\$ 22,298</u>

Leadership participates in four joint ventures. Two of these joint ventures are with certain Pritzker Trusts (the Pritzker family, through trusts and other entities own all of the outstanding capital stock of GL Corporation, Cerro-Marmon's parent) each of which provides for Leadership's participation in 50% of the profits and losses. These two ventures hold unimproved property and have not made any sales. While Leadership has no investment in these particular ventures, it is contingently liable to lenders for approximately \$19,200,000 of notes payable by the joint ventures. Leadership, however, would have recourse to the joint ventures. At December 31, 1976, approximately \$18,200,000 of such debt of one of the joint ventures was in default and actions for foreclosures had been filed by certain noteholders. The ultimate exposure to Leadership of these contingencies cannot be determined and no provision has been included in the financial statements as of December 31, 1976.

(C) Other Assets

Other assets include \$2,255,000 due from The Communities Group, Inc. of Broward County (Communities), a subsidiary of GL. During 1976, Leadership sold to Communities approximately \$2,243,000 of land at book value subject to existing indebtedness of approximately \$333,000.

(D) Notes Payable

Notes payable at December 31, 1976, after giving effect to a February 22, 1977 exchange of assets by Leadership for the cancellation of a bank loan agreement, are as follows:

Financial institutions -	
Unsecured, non-interest bearing, due \$3,000,000 annually	\$ 9,510
Secured, interest from 8.75% to prime plus 4%, due in installments	7,690
Other, substantially all secured, discounted to provide effective interest rates of 8% to 10%, due in installments	<u>37,050</u>
	<u>\$ 54,250</u>

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The unsecured note, which has a face value of \$12,000,000 and has been discounted to reflect a 10% interest rate, is guaranteed by Cerro-Marmon.

A Master Loan Agreement with a bank imposes certain restrictions on Housing Group, including restrictions on the payment of dividends and redemption of stock.

(E) Other Matters

In connection with a 1972 sale of land to the Pritzker Trusts, Leadership was required to repurchase certain portions of such land and had an option to purchase another portion. The repurchase price was Leadership's sales price, the Trust's development and carrying costs and a specific premium. In February 1977, Leadership and the Trusts agreed to cancel each others' rights and obligations in connection with the repurchase and other related agreements. Under terms of the cancellation agreement, a purchase money second mortgage held by Leadership was modified with respect to payment terms, such that the ultimate collectibility cannot be determined and, therefore, the mortgage note receivable of \$2,980,000 has not been reflected in the balance sheet of Leadership.

As a result of the formation of Housing Group and Communities, Leadership is no longer involved in the construction and sale of single family houses, condominiums or multi-family projects. Leadership's future activities will be limited principally to the sale of land presently owned to Communities and other buyers.

The real estate subsidiaries are liable for obligations incurred in the normal course of business for rentals, the completion of contracts relating to the construction of houses, purchases of land, improvements of property sold and guarantees to purchasers of apartment projects. In addition, real estate development is contingent on obtaining required approvals and permits from various government agencies. Leadership is a defendant in lawsuits arising in the normal course of business and is obligated under long-term leases for which provision has been made for the possible loss from these and certain other claims and obligations.

10. Investments - Other

Other investments consist of:

	December 31,	
	1976	1975
Southern Peru Copper Corporation	\$ 5,450	
Miscellaneous (principally foreign)	2,200	\$ 1,569
	<u>\$ 7,650</u>	<u>\$ 1,569</u>

Southern Peru Copper Corporation (SPCC)

Although management believes the investment in SPCC has significant value, no portion of Cerro-Marmon's purchase cost of Cerro was assigned to the investment in SPCC as an appropriate basis for assigning such cost was not readily available. An allocation of a portion of the purchase cost to the investment in SPCC would not have materially affected the consolidated financial statements of Cerro-Marmon. The amount shown for the investment in SPCC represents amounts invested in SPCC after February 24, 1976.

In late February 1976, Cerro-Marmon contributed \$4,450,000 to the capital of SPCC, its then proportionate share (22.25%) of a capital subscription aggregating \$20,000,000. This capital subscription was required by SPCC's lenders, prior to the lenders granting waivers under their financing agreements with SPCC, so that SPCC could obtain additional credit to meet cost overruns incurred in the development of its Cuajone mine. Because the projected costs of Cuajone

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exceeded available funds, including the above \$20,000,000, SPCC's lenders required an additional equity offering of \$25,000,000. Cerro-Marmon contributed \$1,000,000 under such offering, which had the effect of reducing Cerro-Marmon's equity interest in SPCC to 21.02%.

SPCC has not paid dividends since 1972. SPCC's net income (loss) was \$8,354,000 and (\$9,597,000) for 1976 and 1975, respectively. Cerro-Marmon's equity in SPCC's net assets, as reported by SPCC, was \$62,478,000 at December 31, 1976.

Pursuant to Peruvian law, the mining community, made up of SPCC's employees, will acquire increasing participation in the profits and ownership (eventually to 50%) of the mining enterprises in which they are employed.

#### Investments Sold in 1976

During 1976, Cerro-Marmon sold (1) its investment in a 71.25% owned subsidiary in Greece (Zidani Asbestos Mine Project), (2) the assets of Cerro Spar Corporation, a wholly-owned domestic fluorspar mining company and (3) its 24% interest in Northwest Iron Co., Ltd. (Northwest). The gain from these sales, less operating losses in 1976 to dates of sale, of \$948,000 is included in "Revenues - miscellaneous" in the consolidated statement of income.

Cerro-Marmon is contingently liable, together with the major stockholder of Northwest, to advance sufficient funds to Northwest to maintain working capital, as defined, at \$500,000 until certain indebtedness (\$10,879,000 outstanding at December 31, 1976) is repaid. In connection with the sale by Cerro-Marmon of its interest in Northwest, the major stockholder of Northwest has agreed to hold Cerro-Marmon harmless with respect to this working capital maintenance obligation. Management does not expect Cerro-Marmon to be required to make any payments as a result of this contingent obligation.

#### 11. Property, Plant and Equipment

Property, plant and equipment are summarized below:

	December 31,	
	1976	1975
Land	\$ 3,779	\$ 2,064
Buildings and improvements	31,562	21,590
Machinery and equipment	64,158	34,027
Mining properties	20,264	
Utility plant	6,198	
Construction in progress	6,272	424
	132,233	58,105
Less accumulated depreciation and depletion	32,141	21,884
	<u>\$ 100,092</u>	<u>\$ 36,221</u>

#### 12. Financing Obligations

(A) The following table summarizes long-term debt and lease purchase obligations:

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	Interest Rate	Due	December 31,	
			1976	1975
Notes to banks (a)	Prime plus ½% and 1%	1977-1981		\$ 68,000
Notes to institutions (b)	6%-6-3/8%	1977-1987	\$ 27,636	
Notes to corporations (c)	9½%	1977-1987	35,000	
Notes to individuals (d)	5%	1977-1980	7,446	
Subordinated debentures (e)	7%	1977-1990	3,756	
Subordinated notes	12%	1977-1981	3,863	
Lease purchase obligations (f)	3½%-9½%	1977-1994	21,485	17,307
Other	5%-10%	1977-1990	10,053	979
			<u>109,239</u>	<u>86,286</u>
Less current portion			<u>11,800</u>	<u>4,886</u>
			<u>\$ 97,439</u>	<u>\$ 81,400</u>

- (a) This debt of Marmon was prepaid in 1976 with funds obtained from a \$25,000,000 cash contribution by Cerro-Marmon and a \$26,000,000 demand loan from Cerro-Marmon together with Marmon's internally generated funds.
- (b) Discounted to an effective interest rate of 9%.
- (c) Secured by certain coal mining properties.
- (d) To be paid as cash is generated by certain coal mining operations, with payments estimated to be made annually in approximately equal amounts. Discounted to an effective interest rate of 9½%.
- (e) Convertible into common stock of Cerro-Marmon's subsidiary (Golconda Corporation) at \$10.67 per share and redeemable at Golconda's option at prices slightly above par. The amount shown has been discounted to an effective interest rate of 10%.
- (f) Secured by certain property, plant and equipment.

Scheduled maturities of the long-term debt and lease-purchase obligations in the calendar years 1978-1981 are \$12,919,000 in 1978, \$12,270,000 in 1979, \$9,669,000 in 1980 and \$10,555,000 in 1981.

The various debt agreements impose certain restrictions on Cerro-Marmon and certain subsidiaries (including Marmon), including restrictions on the payment of cash dividends and the repurchase of capital stock. Pursuant to the most restrictive provisions of the agreements, Cerro-Marmon could not pay dividends on or repurchase common stock at December 31, 1976. However, under the agreements there was approximately \$60,000,000 available for the payment of dividends on, and redemptions of, preferred stock at that date.

(B) Certain subsidiaries have a formal domestic credit line, expiring April 30, 1977, in the amount of \$12,500,000 and informal domestic and foreign credit lines in the amount of \$61,000,000. All significant credit lines provide for informal compensating balance requirements, generally in an amount equal to 10% of the credit line or 10% of outstanding borrowings thereunder. In one instance a credit line restricts dividend payments and stock repurchases by a subsidiary. Compensating balance requirements are generally satisfied by the normal time lag in presentation of checks for payment.

The daily weighted average short-term bank borrowings and the maximum amount of aggregate short-term bank borrowings outstanding at any month end during 1976 were \$14,080,000 and \$39,480,000, respectively. The weighted average interest rates at December

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31, 1976 and for the year then ended were 8.26% and 7.39%, respectively. Unused credit lines at December 31, 1976 aggregated \$34,020,000.

Notes payable to banks at December 31, 1976 were collateralized by a substantial portion of metal trading inventories (Note 6).

### 13. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31,	
	1976	1975
Compensation	\$ 8,132	\$ 3,256
Pension and profit sharing	5,337	2,252
Insurance	5,310	1,633
Taxes, other than income taxes	3,996	674
Interest	1,571	963
Other	9,185	1,833
	<u>\$ 33,531</u>	<u>\$ 10,611</u>

### 14. Retirement Plans

Cerro-Marmon has several pension and profit sharing plans covering substantially all of its employees.

The actuarially computed value of vested benefits under the pension plans exceeded, as of December 31, 1976, the respective pension fund assets and related balance sheet accruals by approximately \$9,400,000. At that date unfunded past service costs totalled approximately \$18,500,000.

Retirement plan expense included in the consolidated statement of income is as follows:

	1976	1975
Pension plans	\$ 4,782	\$ 1,221
Profit sharing plans	1,349	1,081
	<u>\$ 6,131</u>	<u>\$ 2,302</u>

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## 15. Income Taxes

Cerro-Marmon will be included in the consolidated federal income tax return of GL. Prior to February 25, 1976, Marmon was included in GL's consolidated federal income tax return. Pursuant to a formal tax sharing agreement with GL, federal income taxes of Cerro-Marmon will be determined, in general, as if the former Cerro affiliated tax group and the former Marmon affiliated tax group each filed separate consolidated tax returns. Prior to February 25, 1976, federal income taxes of Marmon were determined, in general, as if Marmon and its domestic subsidiaries filed a separate consolidated federal income tax return. Federal income taxes so determined are to be paid periodically to GL except that (1) the former Cerro affiliated tax group shall not be required to make any tax sharing payments during any taxable period in which Cerro-Marmon has not currently paid all prescribed dividends or made sinking fund payments on its Series A preferred stock and (2) during all other taxable periods the former Cerro affiliated group shall retain, without restriction, 50% of any tax sharing payments that would be due to any member of the GL affiliated group. No income taxes are payable to GL by the former Cerro affiliated group for 1976. As a member of the GL consolidated federal income tax group, Cerro-Marmon (and Marmon prior to February 25, 1976) is contingently liable for the federal income taxes of the other members of the group. GL has indemnified Cerro-Marmon (and Marmon) for any federal income taxes attributable to other members of the group.

Federal income taxes accrued but not yet paid to GL and payments to GL in excess of amounts accrued are included in "Income taxes" and as "Refundable income taxes", respectively, in the consolidated balance sheet. Interest at 115% of the prime rate of a specified bank is paid or received on differences between payments made and payments due. The amount shown as "Income taxes" in the December 31, 1976 consolidated balance sheet includes \$1,108,000 of deferred income taxes.

Examinations by the Internal Revenue Service (Service) of Cerro's federal income tax returns for the years 1965 through 1971 have been substantially completed and additional liabilities have been proposed by the Service. The Service is in the initial stages of an examination of Cerro's federal income tax returns for the years 1972 through 1974 and has not progressed sufficiently to form any conclusions relating to matters reflected in such returns. Cerro's returns include the effects of complex transactions among which is the 1974 expropriation of Cerro's subsidiary, Cerro de Pasco (C de P), discussed below.

On January 1, 1974, C de P was expropriated by the Peruvian government resulting in a loss of \$135,000,000 which was reflected in Cerro's federal income tax return for 1974. On January 22, 1974, the Service advised Cerro by a private ruling letter that it considered the 1974 C de P expropriation loss to have resulted from a compulsory or involuntary conversion of the stock of C de P and that the loss qualified as an ordinary loss which could be carried over and applied against the Cerro affiliated group income for as long as ten years to the extent not utilized during the taxable year in which it arose. By letter dated May 12, 1976, the Service advised Cerro-Marmon that the January 22, 1974 ruling letter was being retroactively revoked with respect to the conclusion that the loss was an involuntary conversion of the stock of C de P and held that the transaction will be treated as an expropriation of assets. During the course of the current examination of Cerro's federal income tax returns, the Service has insisted upon physically examining the books and records of C de P in Peru in order to verify the basis of C de P's assets. To date the Service has not received permission from the Government of Peru to conduct the examination in Peru. Nevertheless, present management believes that the adjusted basis of C de P's assets ultimately can be established.

Income to be reported for income tax purposes for 1976 includes approximately \$50,000,000 from advanced payments received on copper sales. Certain prior returns of Cerro included amounts from similar sales. For income tax purposes, but not for financial reporting purposes, such payments are reported as sales in the year of receipt while the related cost of sales is reported at the time of delivery, which as to the 1976 sale occurred in January 1977. Generally, to the extent that the cost of copper sales reported at time of delivery is not offset by taxable income in the

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same year, a net operating loss will result which may (within certain limitations) be carried back and then, to the extent unused by carryback, carried forward against income of future years. Advance payment transactions, like other business transactions, are subject to examination by the Service. These transactions and any future advance payment transactions could influence the possibilities of ultimate realization of the future tax benefits available as well as the timing of such realization.

On the basis of presently known information, Cerro-Marmon management, who were not part of Cerro management in 1974 or prior years, believe (1) that adequate provision has been made for additional liabilities that may be assessed for the years 1965 through 1971, (2) that no significant change will be made in Cerro's federal income tax position for the periods subsequent to 1971 from that reflected on Cerro's income tax returns for such periods, and (3) that the federal income tax benefits available to Cerro-Marmon from prior losses of Cerro, which are in excess of \$25,000,000 at December 31, 1976, will be realized. However, as a result of the uncertainties raised by the retroactive revocation of the January 22, 1974 ruling letter, the present inability to obtain permission from the Government of Peru for the Service to travel to Peru and the matters discussed in Note 3, conservative accounting practice dictates that recognition of the income tax benefits of the prior Cerro losses be deferred until all significant matters relating to Cerro's prior year income tax position are resolved. See Note 3 as to Cerro-Marmon's accounting for the income tax benefits of Cerro's prior losses when such benefits are realized.

Income tax provisions consist of the following:

	<u>1976</u>	<u>1975</u>
United States:		
Current	\$ 13,096	\$ 10,331
Deferred	3,089	805
Provision in lieu of income taxes	7,397	65
Foreign:		
Current	162	
Deferred	720	355
State and other:		
Current	3,424	1,489
Deferred	<u>1,663</u>	
	<u>\$ 29,551</u>	<u>\$ 13,045</u>

The provisions shown above include the following amounts allocated to the discontinued trucking business.

	<u>1976</u>	<u>1975</u>
Relating to Marmon's equity in the net income of Cerro's trucking subsidiary prior to February 25, 1976	\$ 25	\$ 190
Relating to the trucking subsidiary subsequent to February 24, 1976	<u>1,476</u>	
	<u>\$ 1,501</u>	<u>\$ 190</u>

The income tax effects of significant items which resulted in effective tax rates of 42.6% in 1976 and 52% in 1975 on reported income before income taxes, equity in net income of Cerro and income of discontinued business are detailed below:

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	<u>1976</u>	<u>1975</u>
Theoretical federal income taxes (at 48%) on reported income	\$ 31,600	\$ 11,863
Increase (reduction) resulting from:		
Excess of tax depreciation over financial statement depreciation*	(1,747)	
Excess of tax depletion (percentage depletion basis) over financial statement depletion*	(964)	
Excess of financial statement gains on asset dispositions over tax basis amounts*	(2,417)	
State and other income taxes less federal income tax benefits	2,645	774
Investment tax credits	(902)	(526)
Taxes on Marmon's equity in net income prior to February 25, 1976 from continuing operations of Cerro	103	748
Other - net	<u>(268)</u>	<u>(4)</u>
Income taxes reported	<u>\$ 28,050</u>	<u>\$ 12,855</u>

\* The acquisition of Cerro was a non-taxable transaction and the income tax basis of Cerro's assets became Cerro-Marmon's income tax basis. Such tax basis exceeds the financial statement basis of certain property, plant and equipment and investments after the allocation of the purchase cost of Cerro (Note 2). This results in an excess of tax basis depreciation and depletion over the financial statement amounts and greater gains or lesser losses on disposition of these assets for financial statement purposes than for income tax purposes.

The effective income tax rate of 31.4% on income of the discontinued business subsequent to February 24, 1976 is less than 48% due principally to investment tax credits (\$190,000), the excess of tax over financial statement depreciation (\$582,000) and the excess of financial statement gains on property dispositions over the tax amount (\$211,000). Federal income taxes were provided at an effective rate of 7.2% on Marmon's equity in the net earnings of Cerro's trucking subsidiary prior to February 25, 1976 (Note 4E).

With the exception of \$3,015,000 of deferred federal income taxes provided in 1976 on certain metal trading gains and \$628,000 of deferred federal income taxes provided in 1975 applicable to the equity in the undistributed net income of Cerro, deferred federal income taxes applicable to each other type of difference are less than 5% of theoretical federal income taxes in each year. Provisions for federal income taxes are expected to exceed income taxes payable in the three years subsequent to 1976 due to the availability of prior Cerro losses.

#### 16. Litigation

(A) Cerro-Marmon is subject to the possible effects of various class action and derivative litigation commenced against several defendants, including GL, Cerro and Marmon in 1975 and 1976 relating principally to the termination agreement made with a former chairman of the board of directors of Cerro and the purchase of Cerro stock by Marmon and GL in 1974 and the subsequent merger of Cerro into Cerro-Marmon. These actions allege violations of the anti-fraud provisions of the federal securities laws and common law and derivative claims and various wrongdoings on the part of the various defendants and request various reliefs.

In April 1976, the parties involved in the actions agreed to two stipulations of settlement whereby (1) with respect to the class actions, GL is to pay for the benefit of the defined plaintiff classes (former Cerro common shareholders) up to \$2,336,000 for settlement of the actions, plaintiffs' counsels' fees and expenses and other costs and (2) with respect to the

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derivative actions, certain of the defendants, other than Cerro-Marmon, are to pay to Cerro-Marmon \$750,000 (including amounts to be paid for plaintiffs' counsels' fees and expenses) for settlement of the derivative claims. Further, Cerro-Marmon has agreed that any recovery from the above described derivative actions will be applied to the regular dividends on the \$2.25 Cumulative Series A Preferred Stock. The trial court approved the settlement terms of both the class actions and the derivative actions on January 10, 1977 and the derivative and class actions were dismissed. On February 7, 1977, a notice of appeal was filed with respect to the dismissal of the class action only. No appeal was taken with respect to the derivative actions and these actions have been disposed of; payment of the monies involved is expected to occur in the second quarter of 1977. The amount to be paid by GL pursuant to the class actions has been reflected in the 1976 Cerro-Marmon consolidated financial statements as a contribution to capital and as additional cost of Cerro stock acquired.

(B) In February 1976 another class action relating to the merger of Cerro into Cerro-Marmon was filed in New York State Court against several defendants including Marmon, Cerro and Cerro-Marmon. This action is based on several alleged causes of action, and asks that there be an injunction against a merger between Cerro and Cerro-Marmon that will divest the public shareholders from a residual equity position, or on terms other than as are presented to the court and determined by it to be fair, and for costs including attorneys' fees to the plaintiffs. In February 1976 the injunction to stay the merger was denied; this denial has been appealed. An action, substantially similar in all respects to the February 1976 action discussed above, except that it also alleges violation of the anti-fraud provision of federal securities law, was subsequently filed in Federal Court in New York. When the aforementioned appeal of the approval of the settlement and the class action dismissal is resolved, these cases will be disposed of in accordance with the resolution of the appeal.

In the opinion of counsel, the appeal of the dismissal of the class actions referred to in (A) above will not be sustained and the litigation referred to in (A) and (B) above will be settled on the basis described.

(C) As part of the business combination between GL, Marmon, Cerro and Cerro-Marmon, and specifically the merger of Cerro into Cerro-Marmon, 64,245 shares dissented as to said merger and are involved in a dissenting shareholders' appraisal proceeding which is currently pending in a New York State court. The sole issue to be determined in this proceeding is the price per share to be paid to the dissenting shareholders, and it is not expected that the decision rendered in this proceeding will have a materially adverse affect upon Cerro-Marmon.

(D) In September 1975 an action was commenced in the Supreme Court of the State of New York which alleges that certain defendants including GL, Marmon and Cerro owe the plaintiff a finder's fee of \$750,000 by reason of an alleged agreement to pay a finder's fee equal to the reasonable value of the plaintiff's services upon the acquisition of control of any business entity. The complaint also alleges that Cerro impliedly agreed to pay the plaintiff such a finder's fee and seeks damages against Cerro in the amount of \$750,000. This case has been dismissed in New York and refiled in the Federal Court in Illinois. The matter is currently pending. The outcome will not have a material effect on the consolidated financial statements of Cerro-Marmon.

#### 17. Capital Stock

The authorized capital stock of Cerro-Marmon consists of 10,000,000 shares of \$1 par value preferred stock and 10,000,000 shares of \$1 par value common stock.

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Preferred -

Shares issuable, February 24, 1976	4,324,970
Less - Shares surrendered for cash at \$19 per share	1,668
Shares in dissent seeking appraisal rights	<u>64,245</u>
Shares issued and outstanding at December 31, 1976 (including 141,769 shares held in trust for unlocated shareholders)	<u>4,259,057</u>

These shares, designated "\$2.25 Cumulative Series A Preferred Stock", became issuable under the terms of the merger agreement dated January 15, 1976. The preferred shares are entitled to dividends at the annual rate of \$2.25 per share on a cumulative basis, a liquidation preference of \$22 per share plus accrued dividends, and one vote per share. All or part of the Series A stock may be redeemed by Cerro-Marmon on or after April 1, 1981 at \$22 per share plus accrued dividends. Commencing in 1982, 6-2/3% of the Series A shares issued are to be redeemed annually until all such shares are redeemed or acquired by Cerro-Marmon. Pursuant to the terms of the settlement of certain litigation (Note 16), the annual dividend rate on the Series A stock will be increased to \$2.35 per share beginning in 1981.

The amount shown in the consolidated statement of income for the year ended December 31, 1976 as income applicable to preferred stock consists of \$8,136,000 of dividends and \$873,000 for the accrual of the excess of the redemption value over the value assigned to the Series A Preferred Stock, both for the period February 25, 1976 through December 31, 1976.

Common -

At December 31, 1976, 5,000,000 shares of common stock were issued and outstanding (entitled to four votes per share). Pursuant to the terms of the proposed settlement of certain litigation (Note 16), no payments can be made with respect to the common stock until consolidated shareholders' equity is \$10,000,000 greater than such equity on February 24, 1976. See Note 12 for restrictions on dividends under terms of the debt agreements.

18. Material Transactions with Affiliates

Significant amounts relating to transactions with affiliates during 1976 are as follows:

Management fee income	\$ 394
Interest income	292
Brokerage expense (coal sales)	819
Rental expense	443
Insurance premium expense	389

Amounts of sales to or purchases from affiliates and amounts of receivables from or payables to affiliates, other than amounts shown separately in the consolidated financial statements and income tax amounts (Note 15), are not material. See Note 9 with respect to related party transactions of the real estate subsidiaries.

19. Events Subsequent to December 31, 1976

On January 26, 1977 Hammond Corporation (Hammond) merged into Newham, Inc. (Newham), a newly created wholly-owned subsidiary of Cerro-Marmon, pursuant to a vote of shareholders on such date, approving an Agreement of Merger dated December 20, 1976. Prior to January 26, 1977 GL owned approximately 48% of Hammond's outstanding common stock. Such stock was acquired principally in 1973 and 1974.

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On January 26, 1977 GL contributed its shares of Hammond to the capital of Cerro-Marmon who contributed these shares to Newham. Cerro-Marmon paid \$200,000 to Newham for all of Newham's issued and outstanding common shares. Cerro-Marmon also contributed \$17,611,000 cash to the capital of Newham, which acquired, through a cash merger, all of the outstanding common stock of Hammond (held by persons other than Newham) for \$7.75 per share and all of the outstanding preferred stock of Hammond for \$75 per share. The shares of common stock of Hammond held by Newham and shares held in Hammond's treasury were cancelled. Newham, the surviving corporation, then changed its name to Hammond Corporation.

This transaction will be accounted for by Cerro-Marmon as a purchase. Accordingly, the net assets of the businesses formerly conducted by Hammond that are to be included in the consolidated balance sheet of Cerro-Marmon will be adjusted to reflect the allocations of purchase cost to Hammond's net assets. The carrying value of such net assets in Hammond's balance sheet exceeded Cerro-Marmon's cost of Hammond's net assets at January 31, 1977 (unaudited) by approximately \$3,500,000.

Had the acquisition of Hammond taken place on January 1, 1976, the consolidated net sales and net income of Cerro-Marmon for the year ended December 31, 1976, on an unaudited pro forma basis, would have been increased by approximately \$127,000,000 and \$4,000,000, respectively, after giving effect to a preliminary allocation of Cerro-Marmon's purchase cost of Hammond and to interest on the funds used in the purchase.

On March 31, 1977 a party claiming to be a former common shareholder of Hammond filed what is purported to be a class action against Hammond, Newham, GL and certain of the Cerro-Marmon directors, as well as Cerro-Marmon, alleging certain federal securities law violations, common law fraud and violation of fiduciary duties. The complaint and the allegations contained therein are currently being reviewed, but in the opinion of counsel the complaint is without merit and any decision rendered with respect to this proceeding will not have a materially adverse affect upon Cerro-Marmon.

Subsequent to December 31, 1976, Cerro-Marmon negotiated the termination of long-term employment and other related contracts with certain officers of a subsidiary at an estimated cost, before related income taxes, of approximately \$4,000,000.

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20. Quarterly Data (unaudited)

	1976 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
Sales:				
As previously reported	\$ 203,496	\$ 250,067	\$ 249,309	
As restated	194,662	221,188	214,103	\$ 209,192
Cost of sales:				
As previously reported	178,562	207,703	204,912	
As restated	170,914	183,973	172,181	176,447
Income before income taxes, equity in net income of Cerro and discontinued business:				
As previously reported	12,394	22,630	23,771	
As restated	11,715	19,190	23,163	11,765
Income from continuing operations:				
As previously reported	7,906	11,621	12,666	
As restated	8,159	11,014	13,294	6,752
Net income:				
As previously reported	7,906	11,621	12,666	
As restated	8,878	12,193	14,479	7,209

The restated amounts shown above reflect restatements for (1) amounts applicable to the trucking subsidiary classified as a discontinued operation in the fourth quarter, (2) reclassifications to cost of sales of certain amounts improperly included in revenues in the first three quarters, (3) adjustments to reflect the effects of changes in purchase cost allocations from the initial tentative allocations made in the first quarter and (4) retroactive reflection of certain inventory adjustments determined in the fourth quarter that were applicable to prior quarters.

21. Replacement Cost Data (unaudited)

Pursuant to a rule of the Securities and Exchange Commission, Cerro-Marmon's annual report on Form 10-K discloses quantitative information with respect to the estimated replacement cost of inventories and productive capacity at December 31, 1976 and the related estimated amounts of cost of sales and depreciation expense on a replacement cost basis for the year then ended. A copy of Cerro-Marmon's annual report on Form 10-K is available upon request.

Cerro-Marmon's reported operating results are significantly affected by the lower depreciation expense which results, in part, from the allocation of Cerro-Marmon's purchase cost to Cerro's net assets. The replacement of Cerro-Marmon's productive capacity would require a substantially greater capital investment than was required to acquire the existing productive capacity and, consequently, a substantially greater depreciation expense.

In the opinion of management, the replacement cost data contained in its 1976 Form 10-K is of little analytic value since the data does not necessarily reflect management's intentions as to replacement; additionally, the data necessarily involves highly subjective assumptions and judgments and does not address financing and operating cost considerations which would influence ultimate replacement decisions.

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CERRO-MARMON CORPORATION  
FIVE YEAR SUMMARY OF OPERATIONS (Note 2)  
(In thousands of dollars)

The following summary of operations consists of (1) the consolidated statement of income of Marmon (Cerro-Marmon's accounting predecessor company) and all subsidiaries, including Marmon's 45.33% interest in Cerro accounted for on an equity basis for periods prior to February 25, 1976, and (2) the consolidated statement of Cerro-Marmon and all significant subsidiaries, except the real estate subsidiaries and the trucking subsidiary which is to be sold, for the period commencing February 25, 1976. This statement should be read in conjunction with the consolidated statements of Cerro-Marmon and the Certified Public Accountants' report with respect thereto, which is qualified as set forth therein, and the pro forma summary of income contained elsewhere in this annual report to shareholders.

	<u>1976</u>	<u>1975</u>	<u>1974</u>	<u>1973</u>	<u>1972</u>
Revenues	<u>\$839,145</u>	<u>\$277,108</u>	<u>\$269,135</u>	<u>\$189,223</u>	<u>\$152,554</u>
Costs and expenses:					
Cost of sales	703,515	217,790	212,627	150,108	122,397
Selling and administrative	58,455	26,580	23,421	19,037	16,668
Interest	<u>11,342</u>	<u>8,024</u>	<u>5,314</u>	<u>723</u>	<u>850</u>
	<u>773,312</u>	<u>252,394</u>	<u>241,362</u>	<u>169,868</u>	<u>139,915</u>
Income before amounts shown below	65,833	24,714	27,773	19,355	12,639
Income taxes (Note 15)	<u>28,050</u>	<u>12,855</u>	<u>14,227</u>	<u>9,879</u>	<u>6,200</u>
Income before equity in net income of Cerro Corporation and discontinued business	37,783	11,859	13,546	9,476	6,439
Equity in net income of Cerro Corporation (Note 7)	<u>1,436</u>	<u>10,384</u>	<u>3,180</u>		
Income from continuing operations	39,219	22,243	16,726	9,476	6,439
Income of discontinued business less income taxes (Note 8)	<u>3,540</u>	<u>2,460</u>	<u>1,032</u>		
Net income	42,759	24,703	17,758	9,476	6,439
Net income applicable to preferred stock (Note 17)	<u>(9,009)</u>				
Net income applicable to common stock	<u>\$ 33,750</u>	<u>\$ 24,703</u>	<u>\$ 17,758</u>	<u>\$ 9,476</u>	<u>\$ 6,439</u>

Note references are to Notes to Consolidated Financial Statements.

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Lines of business information - historical (unaudited)

The following table sets forth the historical amounts of sales and income before income taxes from the continuing operations of Marmon for all periods prior to February 25, 1976 and Cerro-Marmon's amounts for the period from February 25, 1976 to December 31, 1976, adjusted to give effect to the merger of Cerro into Cerro-Marmon on February 24, 1976. This table should be read in conjunction with the pro forma statements and Managements' Discussion and Analysis of Results of Operations contained in this annual report to shareholders:

	<u>1976</u>	<u>1975</u>	<u>1974</u>	<u>1973</u>	<u>1972</u>
	(In millions of dollars)				
<b>Sales:</b>					
Manufacturing -					
Pipe and tubing (1)	\$180.0	\$ 88.9	\$105.9	\$ 69.5	\$ 46.1
Wire and cable (1)	102.0				
Metal products (1)	95.0				
Automotive products	92.3	76.2	75.0	52.1	43.2
Mining equipment	69.0	77.2	46.6	27.6	24.8
Building products	28.3	20.8	32.1	31.0	31.3
Total Manufacturing	566.6	263.1	259.6	180.2	145.4
Metal trading (1)	176.6				
Coal mining (1)	75.2				
All other	9.8	12.4	8.0	8.1	6.2
	<u>\$828.2</u>	<u>\$275.5</u>	<u>\$267.6</u>	<u>\$188.3</u>	<u>\$151.6</u>
<b>Income from Continuing Operations:</b>					
Manufacturing -					
Pipe and tubing (1)	\$ 14.3	\$ 5.9	\$ 15.2	\$ 7.3	\$ 3.0
Wire and cable (1)	8.7				
Metal products (1)	7.3				
Automotive products	9.2	7.8	6.3	6.4	4.3
Mining equipment	11.9	15.8	7.4	2.8	2.8
Building products	5.9	2.2	2.7	3.4	2.8
	57.3	31.7	31.6	19.9	12.9
Metal trading (1)	6.0				
Coal mining (1)	11.7				
All other (2)	(9.2)	(7.0)	(3.8)	(.5)	(.3)
	<u>\$ 65.8</u>	<u>\$ 24.7</u>	<u>\$ 27.8</u>	<u>\$ 19.4</u>	<u>\$ 12.6</u>

1. On February 24, 1976 Cerro-Marmon acquired Cerro, which businesses comprise all, or a major portion, of these lines of business. For information with respect to the discontinued trucking operations and real estate operations, see Notes 8 and 9 to Notes to Consolidated Financial Statements.

2. Includes interest and dividend income, gains or losses on temporary investments, residual amounts of unallocated or over-allocated corporate administrative expenses, interest expense, other than interest expense directly attributable to metal trading, and miscellaneous other amounts not attributable to a specific line of business.

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CERRO-MARMON CORPORATION  
PRO FORMA STATEMENT OF INCOME  
(In thousands of dollars)

(UNAUDITED)

	<u>Years Ended December 31,</u> <u>(Notes A and B)</u>	
	<u>1976</u>	<u>1975</u>
Revenues:		
Sales	\$908,390	\$753,837
Miscellaneous - net	<u>12,933</u>	<u>13,494</u>
	<u>921,323</u>	<u>767,331</u>
Costs and expenses:		
Cost of sales	772,311	622,657
Selling and administrative	63,412	62,685
Interest	<u>12,738</u>	<u>16,522</u>
	<u>848,461</u>	<u>701,864</u>
Income of continuing operations before income taxes	72,862	65,467
Income taxes	<u>31,238</u>	<u>30,297</u>
Income of continuing operations	41,624	35,170
Income of discontinued trucking business, less income taxes	<u>3,586</u>	<u>3,428</u>
Net income	<u>\$ 45,210</u>	<u>\$ 38,598</u>

See accompanying notes.

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Lines of business information - pro forma (unaudited)

Years ended December 31,  
1976      1975  
(In millions of dollars)

Sales:

Manufacturing -		
Pipe and tubing (1)	\$ 194.8	\$ 147.0
Wire and cable (1)	118.0	115.8
Metal products (1)	113.1	76.7
Automotive products	92.3	76.2
Mining equipment	69.0	77.2
Building products	28.3	20.8
Total Manufacturing	615.5	513.7
Metal trading (1)	198.0	148.5
Coal mining (1)	85.2	80.0
All other	9.7	11.6
	<u>\$ 908.4</u>	<u>\$ 753.8</u>

Income from Continuing Operations:

Manufacturing -		
Pipe and tubing (1)	\$ 15.2	\$ 9.7
Wire and cable (1)	8.5	19.7
Metal products (1)	10.1	2.8
Automotive products	9.2	7.8
Mining equipment	11.9	15.8
Building products	5.9	2.2
	60.8	58.0
Metal trading (1)	6.1	3.6
Coal mining (1)	13.5	20.8
All other (2)	(7.5)	(16.9)
	<u>\$ 72.9</u>	<u>\$ 65.5</u>

- (1) On February 24, 1976 Cerro-Marmon acquired Cerro, which businesses comprise all, or a major portion, of these lines of business. For information with respect to the discontinued trucking operations and real estate operations, see Notes 8 and 9 of Notes to Consolidated Financial Statements.
- (2) Includes interest and dividend income, gains or losses on temporary investments, residual amounts of unallocated or over-allocated corporate administrative expenses, interest expense, other than interest expense directly attributable to metal trading, and miscellaneous other amounts not attributable to a specific line of business.

See accompanying notes.

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NOTES TO UNAUDITED PRO FORMA STATEMENT OF INCOME  
AND LINES OF BUSINESS DATA

- A. The combination of Cerro and Marmon, as discussed in Note 1 of Notes to Consolidated Financial Statements, significantly affects the comparability of the 1976 results of operations of Cerro-Marmon with the 1975 historical results of operations of Cerro-Marmon's accounting predecessor company (Marmon). The accompanying pro forma information has been provided to facilitate a meaningful comparison of the results of operations for the two years. This pro forma information consists of (1) the combined historical results of Marmon and Cerro for the year ended December 31, 1975 and the period January 1 to February 24, 1976, adjusted to give effect to the allocation of Cerro-Marmon's purchase cost of Cerro to Cerro's net assets as if the merger and acquisition of Cerro had been completed on January 1, 1975, and (2) the historical results of Cerro-Marmon for the period February 25 to December 31, 1976. This information should be read in conjunction with the consolidated financial statements of Cerro-Marmon and related notes.
- B. The reconciliation of historical revenues and net income to pro forma amounts follows. The amounts shown for Cerro-Marmon consist of amounts applicable to Marmon prior to February 25, 1976 and to Cerro-Marmon subsequent thereto. The amounts shown for Cerro and the related pro forma adjustments apply only to periods prior to February 25, 1976.

	Years ended December 31,	
	1976	1975
Revenue:		
Cerro-Marmon	\$ 839,145	\$ 277,108
Cerro	<u>101,971</u>	<u>614,107</u>
Combined	941,116	891,215
Add (deduct) pro forma adjustments:		
Real estate subsidiaries	(6,816)	(49,077)
Discontinued trucking subsidiary	(13,004)	(75,258)
Other - net	<u>27</u>	<u>451</u>
Cerro-Marmon pro forma revenues	<u>\$ 921,323</u>	<u>\$ 767,331</u>
Net income:		
Cerro-Marmon	\$ 42,759	\$ 24,703
Cerro	<u>2,033</u>	<u>(2,410)</u>
Combined	44,792	22,293
Add (deduct) pro forma adjustments:		
Marmon's equity in Cerro net income less income taxes thereon	(1,655)	(12,096)
Net loss of Cerro's real estate subsidiaries	779	21,187
Reduction in Cerro's depreciation and depletion	1,304	6,517
Other - net	<u>(10)</u>	<u>697</u>
Cerro-Marmon pro forma net income	<u>\$ 45,210</u>	<u>\$ 38,598</u>

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS

The following comments relate to the preceding pro forma statement of income and lines of business data. For 1976, Cerro-Marmon had pro forma income from continuing operations before income taxes of \$72.9 million, an increase of 11% from the \$65.5 million in 1975. Pro forma sales for 1976 were \$908.4 million compared to \$753.8 million in 1975, an increase of 21%. Changes between 1975 and 1976 in pro forma sales and income from continuing operations before income taxes for each product line are discussed below.

### Pipe and Tubing

The year 1976 compared to 1975 shows significant improvements with an increase of 33% in sales and 57% in income. These improvements reflect the effect of a strike at a major plant in 1975 and, as to income only, the results of a cost reduction program initiated during the later part of 1975. General economic conditions effecting pipe and tubing customers also began to improve in the latter half of 1975 resulting in higher sales and income. Reductions in metal prices in the fourth quarter of 1976, while causing reduced dollar sales, had no significant effect on income.

### Wire and Cable

While sales increased 2% over 1975, income declined to less than half of the 1975 level. These results reflect severe price competition in 1976, due to reduced product demand in the construction and capital goods markets and the upward trend in the prices of copper and other related product costs during most of 1976. Declines in copper prices in the fourth quarter of 1976, requiring significant write-downs of inventory to market values, resulted in a loss in that quarter.

### Metal products

Substantial improvements in sales and income over the prior year reflect the effect of a strike at a major plant in 1975. Sales increased from \$76.7 million in 1975 to \$113.1 million in 1976 while income increased from \$2.8 million to \$10.1 million. Basic metal and product pricing improved throughout most of 1976 compared to the depressed levels of 1975 although a decline in copper prices in the fourth quarter resulted in significantly reduced income for the quarter due to inventory write-downs to market values.

### Automotive products

Due to direct association with the automotive industry, which had higher activity in 1976, sales and income of this line increased approximately 20%.

### Mining equipment

This operation experienced declines in both sales and income in 1976 resulting from a slowdown in demand for coal mining equipment from the abnormally high 1975 level. Sales of \$69 million decreased 11% from 1975's \$77.2 million and income declined 25% to \$11.9 million from 1975's \$15.8 million reflecting the effect of reduced demand on selling prices and margins. New orders for mining equipment started to decline in late 1975 and continued to decline through 1976.

### Building products

Sales and income for this line set an all-time record. Sales increased 36% over 1975 and income more than doubled. These results reflect the demand created by increased remodeling and refurbishing of retail stores by major customers.

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#### Metal trading

World-wide metal trading activities showed a sales increase of 33% over 1975 and a 69% improvement in income. The increased market activity in 1976 provided more opportunities for profitable trading. Lower interest costs on the financing of inventories and increased agency and special sale activities all contributed to improved operations.

#### Coal mining

Coal mining operations had improved dollar volume sales due to increased tonnage shipped but reduced earnings principally because of lower selling prices and margins on spot market sales.

#### All other

The reduction in the 1976 charge to income shown as "All other" from the 1975 charge is due principally to the elimination of the costs of duplicate corporate functions and the expenses associated with the 1975 relocation of Cerro's corporate offices from New York to Chicago and to reduced interest charges in 1976 resulting from debt reductions and lower interest rates.

#### Income taxes

The reduction in the effective pro forma income tax rate attributable to pro forma income of continuing operations, from 46.2% in 1975 to 42.9% in 1976, is due principally to 1976 disposals of assets with higher income tax bases than financial statement bases.

#### Fourth quarter 1976

Sales in the fourth quarter of 1976 declined approximately \$5,000,000 or 3% from the third quarter 1976 level, as restated, and income from continuing operations after income taxes declined from \$13,294,000 in the third quarter to \$6,752,000 in the fourth quarter. These declines resulted from the write-downs of inventories to market values to reflect reductions in copper prices in the fourth quarter, the normal seasonal reduction in building product sales and income, a further decline in mining equipment sales and income from earlier levels and reduced sales and income from coal mining operations.

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Directors and Officers

Robert H. Cutler .....	Chairman, Illinois-California Express, Inc., a subsidiary of Cerro-Marmon Corporation
Thomas F. Githens* .....	Senior Vice President and Director Smith Barney, Harris Upham & Co., Inc. (investment banking)
Robert C. Gluth .....	Executive Vice President Cerro-Marmon Corporation
Lewis B. Harder* .....	Chairman (Chief Executive Officer) International Mining Corporation (mining and marine terminal operations)
George A. Jones .....	Executive Vice President Cerro-Marmon Corporation
G. Willing Pepper* .....	Chairman of the Board The Institute for Cancer Research (non-profit research organization)
Jay A. Pritzker .....	Chairman of the Board Cerro-Marmon Corporation
Robert A. Pritzker .....	President Cerro-Marmon Corporation
Alan Wolfley .....	Chairman of the Board Inconcoal Corporation (coal trading)
Frederick J. Manning .....	Treasurer Cerro-Marmon Corporation
Thomas L. Seifert .....	Secretary and Legal Counsel Cerro-Marmon Corporation
John Spevacek .....	Controller Cerro-Marmon Corporation

\* Members of Cerro-Marmon's audit committee.

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# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

## FORM 10-K

### ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1974

Commission file number 1-1518

## Cerro Corporation

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of  
incorporation or organization)

13-1809539

(I.R.S. Employer Identification No.)

300 Park Avenue, New York, New York

(Address of principal executive offices)

10022

(Zip Code)

Registrant's telephone number, including area code (212) 688-8822

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Cerro Corporation Common Stock par value \$3.33-1/2 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X

No

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## PART I

### ITEM 1. BUSINESS

#### GENERAL

Incorporated in New York in 1915 as the successor to mining enterprises in Peru which were commenced in 1902, Cerro Corporation (the term "Cerro" refers to Cerro Corporation and its subsidiaries unless otherwise required by the context) is engaged in the United States in the manufacture and sale of refined copper, copper and brass mill products, electric wire and cable (including co-axial wire and cable and passive devices for sale to the CATV industry); real estate operations; common carrier motor freight operations; and mining. A wholly owned subsidiary, Cerro Sales Corporation ("Cerro Sales"), conducts world-wide trading activities in nonferrous refined metals, concentrates and other raw materials including copper, lead, zinc, silver and bismuth. In addition, Cerro has a 22.25% interest in Southern Peru Copper Corporation, a company which operates a large copper mine in Peru; a 12% interest in an iron ore mining venture in Australia; and various interests in several relatively small mining and manufacturing companies in Peru.

As a result of private purchases and a tender offer concluded on May 29, 1974, Cerro owns approximately 86.6% of the outstanding shares of the Common Stock of Golconda Corporation ("Golconda") and approximately 73.5% of the outstanding shares of its preferred stock, or approximately 85% of Golconda's total voting stock. The total purchase price was approximately \$28,600,000 in cash. Golconda is primarily a manufacturer of capital goods for diverse markets, including gas control devices, food service equipment and precision components for aerospace and other highly technological applications; it also has some small mining interests in the western United States.

On September 25, 1974, Cerro completed the acquisition of 100% of the capital stock of the Fetterolf coal companies located in Somerset County, Pennsylvania, for approximately \$34.0 million in cash. The Fetterolf companies own or lease operating properties containing proven and probable reserves, estimated at approximately 38.5 million tons, of washed saleable coal, principally of metallurgical grade, plus additional reserves the amount of which has not yet been established.

As a result of prior purchases and a tender offer which expired on July 16, 1974, approximately 45% of Cerro's outstanding Common Stock is now owned by The Marmon Group, Inc. (Michigan) ("Marmon"), a wholly owned subsidiary of GL Corporation. GL Corporation is a private corporation beneficially wholly owned by the Pritzker family of Chicago, Illinois. Mr. Jay A. Pritzker is Chairman of the Board of Cerro and Mr. Robert A. Pritzker is President of Cerro. (See Item 4. "Parents and Subsidiaries" on page 29.) In September 1974 Cerro and Marmon agreed in principle upon a merger of Cerro into Marmon. Merger discussions were subsequently terminated. Marmon has informed Cerro that it is again considering a possible merger or other acquisition transaction with Cerro and that it intends to make a proposal therefor. Cerro is advised the terms of any such proposal have not yet been determined. Such terms could involve the issuance to the stockholders of Cerro (other than Marmon) of a security other than Common Stock in exchange for their Cerro Common Stock.

Due to Cerro's tax loss incurred in connection with the expropriation of Cerro de Pasco Corporation on January 1, 1974, Cerro will pay no federal income taxes on its 1974 United States earnings, although, for financial reporting purposes a provision for such taxes has been made in arriving at net income for the year because Cerro recognized such loss completely for financial reporting purposes in 1973. Thus, from a cash flow standpoint, the income tax provision, as well as other non-cash deductions such as depreciation should be considered in appraising Cerro's results for the year. See pages F-3, F-4 and F-5.

During 1974, Cerro received certain compensation for its expropriated mining properties in Peru and Chile, (see "Investments" on page 13).

#### (a) PRODUCTS, SERVICES, MARKETS AND METHODS OF DISTRIBUTION

Functioning through four operating groups, i.e., manufacturing, real estate, trucking, and mining, Cerro's principal products, services rendered, principal markets and methods of distribution are as follows:

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## MANUFACTURING GROUP

The operations of the Manufacturing Group are carried out through Cerro Copper Products Division ("Cerrocu"), Cerro Metal Products Division ("Cerromet"), Cerro Wire and Cable Co. Division ("Cerrowire"), Cerro Communication Products Division ("Cerrocom"), Cerrosales and Golconda.

### Cerrocu

Cerrocu produces and sells copper plumbing tube and related items, thin-wall industrial copper tube, and electrolytic copper cathode. Plumbing tube is sold principally to plumbing wholesalers direct from the mill and through twelve regional warehouses. Industrial tube is sold primarily to original equipment manufacturers. Electrolytic copper cathodes are sold primarily to Cerrosales for resale (see "Cerrosales" below). Cerrocu also distributes a line of plastic plumbing fittings for another manufacturer.

On March 7, 1975 Cerrocu settled an 18 week old strike which had closed down its Sauget, Illinois manufacturing facility by signing a new three-year contract with the United Steelworkers. Management believes the terms of the new contract will permit Cerrocu's operation at Sauget to remain competitive from the standpoint of labor costs for the term of the new contract.

### Cerromet

Cerromet produces and sells brass mill products, including brass and bronze rod, bar, shapes, wire, forgings, screw machine parts and die castings, as well as certain low melting point alloys, principally to original equipment manufacturers and metal distributors.

The principal markets for products manufactured by Cerromet are the housing, automotive, industrial process and control equipment, and communication and electrical equipment industries. In addition to the foregoing, a small portion of Cerromet's total sales are to distributors of brass rod products.

On March 9, 1975 the Bellefonte, Pennsylvania Works of Cerromet, its principal facility, was shut down by a strike of the United Auto Workers following expiration of a labor agreement. Cerromet is a significant operation of the Manufacturing Group.

### Cerrowire

Cerrowire produces and sells single and multi-conductor building wire and cable, control, power and instrumentation cable, aerospace and marine cable, copper wire rod, electrical metallic tubing and co-axial cable.

Cerrowire's products are sold through its own sales offices, manufacturer's representatives, and distributors to (i) the construction industry, (ii) public utilities, and (iii) diversified manufacturers, including those in the defense, maritime, and aerospace industries. In late 1975, it is expected that Cerro will commence the manufacture of intermediate metal conduit in a new building at its Syosset, New York facility. Cerro has acquired a building in East Granby, Connecticut, and related equipment, to expand production of utility wire and cable.

### Cerrocom

In 1974 Cerro's CATV co-axial cable operation in Freehold, New Jersey was given divisional status and combined with the business of a small company in Anniston, Alabama which manufactures and sells passive devices for CATV. Co-axial cable and passive devices are sold directly and through distributors to CATV system builders.

### Cerrosales

Cerrosales conducts worldwide metal trading activities. It hedges on The Commodity Exchange, Inc., the London Metal Exchange and foreign exchange markets. Cerrosales deals in nonferrous refined metals, concentrates and ores, including copper, lead, zinc, silver and bismuth. On December 20, 1974 Cerrosales was appointed copper sales agent in the U.S. and Canada for Corporacion del Cobre, Chile ("Codelco"), an agency of the Government of Chile which oversees most copper production and sales operations of Chile.

### **Golconda**

Golconda is engaged in the manufacture and sale of valves, fittings, regulators and other controls for pressurized gases; precision components and assemblies for use in the following industries: aerospace, aircraft, computers and related products; and kitchen, cafeteria and restaurant equipment for commercial and industrial uses. Golconda's products are sold principally in the United States through a variety of methods, including both direct sales and sales through distributors and dealers. Golconda has entered into an agreement, subject to the fulfillment of certain conditions, for the sale of its food service equipment business.

### **REAL ESTATE GROUP**

Cerro's wholly owned subsidiary, Leadership Housing, Inc., is engaged in the residential real estate business. The term "Leadership" refers to Leadership Housing, Inc., and its subsidiaries unless otherwise required by the context. The principal real estate operations include (i) housing operations consisting of the development, construction and sale of communities of single family homes, including condominium units; (ii) the sale of improved and unimproved land and (iii) the development, construction, sale and management of rental apartment complexes. In addition, Leadership participates in joint ventures engaged in real estate development.

### **Financial Condition**

Leadership's revenues from sales declined from approximately \$160 million in 1973 to approximately \$96 million in 1974 resulting in a pre-tax loss of \$13.6 million in 1974 as contrasted with a pre-tax profit of approximately \$11.9 million in 1973.

During 1974 and the first quarter of 1975, Cerro provided Leadership with a total of approximately \$19.9 million in the form of advances and made an additional capital investment in Leadership of \$2.5 million. In addition, during 1974 Cerro deposited \$6.5 million with Leadership's principal lenders in connection with a compensating balance requirement of Leadership under its revolving credit-term loan agreement (the "Loan Agreement") pursuant to which Leadership borrowed \$42,500,000 during 1973 and 1974. Such deposits are not available to satisfy any liabilities of Leadership. Leadership's lenders have (i) waived, as of December 31, 1974 and as of the present time, all defaults under the Loan Agreement and (ii) have modified those covenants with which Leadership has not been able to comply in such a manner as to cause Leadership to be in compliance at the present time.

During early 1975, a contingency plan was proposed to provide Leadership with additional funds and greater freedom of operation under the Loan Agreement. Under terms presently proposed, but subject to the fulfillment of certain conditions beyond the control of Cerro and Leadership, Cerro would purchase certain assets of Leadership for an aggregate purchase price of \$15 million, of which approximately \$5.9 million is expected to be paid in cash, \$3.75 million by issuance of a Cerro note, and \$5.35 million by forgiveness of prior advances. In addition, Cerro would provide \$10 million cash under terms not yet determined. These actions by Cerro, however, are dependent upon agreement being reached with Leadership's principal lenders with respect to the implementation of the contingency plan. This contingency plan would, among other things, including Cerro's proposed actions described above, provide: for an extension of the Loan Agreement; for relief from the rate of interest presently being charged by such lenders; for relief from compensating balance requirements; and for additional project financing from such lenders and Cerro (see Note 6 to Note 13 of Notes to Financial Statements for a description of the Loan Agreement). As of the date of the filing of this report, letters of intent with respect to the plan had not been executed. However, in the event such letters of intent are executed and delivered, Cerro intends, based on presently known conditions, to support Leadership's ordinary operations during 1975. It is anticipated that such contingency plan, if effectuated, would provide adequate support to Leadership through 1976 under presently known and anticipated conditions. However, there can be no assurance that Leadership will not require additional funds beyond 1975, even assuming that the foregoing plans are effectuated, and Cerro has no present intention of supplying such additional funds if needed.

In the event such letters of intent are not executed and delivered it is the present intention of Cerro's management not to conclude the purchase of such assets, not to provide the additional \$10 million in cash referred to above, and not to provide further financial support to Leadership except to the extent required by existing legally binding commitments. In this connection, the only legally binding material commitment of Cerro in respect of Leadership is pursuant to a General Agreement of Indemnity whereby Cerro has agreed to indemnify certain insurance companies which have issued surety bonds aggregating \$39.4 million guaranteeing Leadership's performance under certain construction contracts. Should Leadership not be able to perform under such contracts, it is anticipated that Cerro may cause such contracts to be performed by Leadership's subcontractors. Although there may not be any material adverse consequences to Cerro by reason of the General Indemnity Agreement a substantial amount of construction covered thereby remains incomplete at March 27, 1975.

If Cerro terminates financial support of Leadership, it is not presently anticipated that Leadership will be able to survive as an on-going business. While it is not possible at the present time to predict whether or not any part of Cerro's investment in Leadership would be recovered in the event Leadership ceases to be an on-going business, Cerro's maximum exposure would be the loss of its entire investment in Leadership which, at March 27, 1975 was approximately \$65.0 million plus the cost of performance referred to above.

Cerro's independent auditors have made their opinion subject to the resolution of this matter. In this connection, see page F-1 and Note 12 to Financial Statements.

The following tables set forth Leadership's revenues and gross profit (loss) from sales for 1974 and 1973, before taxes, attributable to the following real estate operations:

	<u>1974</u>	<u>1973</u>
	(\$ in Thousands)	
Revenues (1)		
Single family housing .....	\$81.098	\$ 84.611
Land Sales .....	2.942	30.071
Multi-family housing .....	8,968	32,712
Other .....	2,998	12,555
	<u>\$96.006</u>	<u>\$159,949</u>
	<u>1974</u>	<u>1973</u>
Gross Profit (Loss) From Operations (2)		
Single family housing .....	\$ 3.802 (3)	\$ 10.882
Land Sales .....	(3,198)(4)	7,981
Multi-family housing .....	(643)	726
Other .....	(2,022)	865
	<u>\$(2,061)</u>	<u>\$ 20,454</u>

(1) Does not include interest income of \$6.8 million and \$5.7 million and equity in joint venture income of \$2.2 million and \$4.3 million for 1974 and 1973, respectively.

(2) Prior to sales and marketing, general and administrative, and non-capitalized interest expenses which are not allocated to the respective operations.

(3) Includes a special charge of \$1.7 million to inventory reflecting a writedown of inventory of single family homes to the estimated net realizable value.

(4) Includes special charges aggregating \$3.6 million reflecting principally a writedown of land to estimated net realizable value, the abandonment of certain options to buy land and the writeoff of a note receivable.

The principal factors underlying Leadership's decline in profitability for 1974 were the impact of the substantially higher interest rates prevailing during that year combined with rapid inflation in material and labor costs.

Leadership's land sales were particularly depressed by the limited availability of mortgage financing for prospective residential purchasers, and the substantially higher interest rates which prevailed during 1974 which resulted in the inability of many potential home buyers to qualify for mortgages. This situation, coupled with buyer uncertainty occasioned by the economic recession in the United States, caused a substantial decrease in new orders for single family homes. The resulting depressed state of the single family home market and the unavailability of financing for residential developments were principal factors underlying the decline in the development and construction of homes by developers and builders other than Leadership, which in turn resulted in a substantial decline in Leadership's revenues and gross profit for 1974 from the sale of land to such developers and builders.

The depressed state of the single family market, however, did not result in a substantial decline in Leadership's revenues for 1974 from the sale of single family homes as compared with 1973, because such revenues for 1974, for the most part, were derived from the closings on homes under contracts entered into in 1973. The gross profit margin, however, on sales of single family homes in 1974 declined substantially due principally to substantially increased costs of interest, labor and material attributable to the construction of homes and the inability to recover these cost increases in full from purchasers of such homes under the terms of Leadership's contracts. See "Single Family Housing" below for information on the decline in the number of contracts entered into for single-family homes during 1974.

Although there was a substantial decline in 1974 in the revenues from the development, construction, sale and management of apartment complexes, this decline resulted primarily from the recognition of income from more projects in 1973 than in 1974 rather than the effect of adverse economic conditions prevailing in the housing industry during 1974. After excluding provisions for future losses aggregating approximately \$800,000 recognized in 1974 in connection with certain guarantees given to purchasers of certain projects, the gross profit from this operation calculated as a percentage of revenues therefrom did not vary significantly in 1974 from that prevailing during 1973.

Leadership's revenues from sales which do not fall within its principal operations and certain production related revenues and expenses are encompassed within the "Other" category appearing in the foregoing table. The decline in gross revenues attributable to this category in 1974 as compared with 1973 results primarily from the sale of an office building and two country clubs in 1973 for approximately \$7.7 million. The loss in 1974 as contrasted with the gross profit in 1973 in this category results from the inclusion in 1973 of a profit of approximately \$1.3 million from the sale of the foregoing properties, an increase in 1974 in production related expenses, a decline in the profitability in 1974 of Richmar Development Corporation, a Leadership subsidiary engaged in the development of commercial real estate properties, and losses of a utility operation.

#### **Single Family Housing**

Leadership's single family housing divisions build single family houses and condominium units developed as single family detached houses, townhouses, and low-rise condominium buildings. Leadership's homes have from two to six bedrooms, are generally of wood frame or cement block with stucco exterior, and have dry wall internal construction.

Leadership's personnel locate land suitable for planned complexes based upon market analyses and research, and perform or supervise the performance of the engineering, rezoning, land planning and construction functions. Leadership acts as the general contractor on all its projects and all work in connection with the construction of residences is performed by subcontractors. Leadership's single family residences are primarily sold by salesmen employed by Leadership and compensated on the basis of salary and commissions, and to a lesser extent by outside brokers who are compensated on a commission basis.

The following table sets forth certain information as of December 31, 1974 and 1973 with respect to homes under construction or completed.

	Homes Under Contract and Under Construction or Completed (1)		Homes Completed or Under Construction But Not under Contract (2)	
	1974	1973	1974	1973
<i>Housing East</i>				
Boca Raton, Florida	10	21	14	5
Tamarac, Florida	276	1,267	238	85
Tampa, Florida	5	259	68	13
	<u>291</u>	<u>1,547</u>	<u>320</u>	<u>103</u>
<i>Housing West</i>				
San Diego, California	41	14	44	23
Leucadia, California	6	30	132	155
Orange County, California	39	65	148	118
San Francisco, California	12	18	9	104
Reno, Nevada	6	—	9	—
	<u>104</u>	<u>127</u>	<u>342</u>	<u>400</u>
	<u>395</u>	<u>1,674</u>	<u>662</u>	<u>503</u>

(1) Although there are contracts covering these homes, there can be no assurance that the purchasers will perform. It has been Leadership's practice to retain all or a substantial portion of the purchasers' deposit and resell the home rather than to enforce such contracts. The purchasers' deposit varies from approximately \$500 on homes sold in California to substantially higher amounts on homes sold in Florida.

(2) Does not include additional homes which are not under construction but which are included in the current plans for the respective developments and which may be subsequently constructed. Includes certain homes on which refundable reservation deposits have been received from the prospective purchaser and which, at the option of such prospective purchaser, may subsequently result in binding contracts.

The following table sets forth information as to contracts entered into for, and deliveries of, single family homes during the years ended December 31, 1974 and 1973, and single family homes contracted for but not delivered as of such dates:

	Year Ended December 31	
	1974	1973
Homes contracted for sale (net of cancellations)	648	2,329
Homes delivered	2,250	2,342
Homes contracted for sale but not delivered at end of period	459	2,061

At December 31, 1974, Leadership had a backlog of orders for 459 single family homes aggregating approximately \$16,000,000 as compared with 2,061 single family homes aggregating \$62,000,000 at December 31, 1973. The decline was due to a number of factors, including the limited availability of mortgage financing, substantially higher mortgage interest rates, buyer concern with the state of the

economy, and the adoption by Leadership of a policy to reduce backlog due to the difficulty of securing contracts with purchasers which protect Leadership against substantial increases in the cost of labor and materials and interest charges attributable to single family homes during the period of construction.

### **Multi-Family Projects**

Leadership constructs for resale multi-family projects usually consisting of two and three story garden apartment complexes located on sites averaging 10 acres and manages the projects for the purchasers thereof. Projects typically are designed in clusters of from 8 to 35 buildings, and contain an average of 275 units. The apartment complexes, which are planned for families and young adults with moderate incomes, include amenities such as landscaped open areas, private patios, recreational clubhouses, swimming pools and other leisure time facilities. Substantially all of the apartments completed thus far have been rented on a month-to-month basis, either with or without leases, in accordance with prevailing local practice.

Most projects are subject to agreements of sale prior to the commencement of construction. Under such agreements, Leadership bears the economic risk of construction of the project and is obligated to complete construction by a specified date.

The purchaser pays a cash down payment and issues Leadership a purchase money note secured by a lien on the property. Most notes are non-recourse and Leadership may look only to the property in the event of a default by the purchaser. Leadership's lien on the property is subordinate to the liens of the lenders who provide construction and permanent financing for the project. The purchase money notes relating to projects commenced since January 1, 1973 have been generally payable in full in not more than two years, but notes issued prior thereto are payable over a period ranging from ten to twenty-seven years.

Projects are sold by Leadership's sales staff primarily to real estate investment trusts and real estate syndicators. Sales of Leadership apartment complexes are structured generally to provide the purchaser with a cash return on its equity investment and income tax shelter during the early years primarily through deductions based on accelerated depreciation, interest paid on mortgage debt, and certain other items. Such transactions are designed to meet varying needs of investors, and the format is influenced by the availability of capital, competitive conditions in the rental market and the tax laws. Proposals have been made before the Congress for changes in the tax laws which, if enacted, could reduce the marketability of such projects. Among other things, the proposals would curtail the tax benefit presently derived from accelerated depreciation, interest paid on construction debt and other presently deductible items and would also provide more favorable tax treatment for income not involving any tax shelter.

After the completion of a project, Leadership manages the apartment complex for the purchaser for a percentage of the gross rentals of the project. Leadership generally does not retain any equity interest in its projects. The management agreements, however, occasionally provide for Leadership to participate in income from operations after the purchaser has received a specified return and for Leadership to share in excess cash in the event the project is refinanced or resold. To date, no significant amount of income from such participations has been received by Leadership.

In substantially all projects, Leadership has guaranteed for a specified period either (i) a fixed rate of return to the purchaser or (ii) that revenues from the project will be sufficient to meet expenses and debt service. Typically, the guaranteed fixed rate of return is for a period of from two to three years after completion, and in some projects under certain conditions may be extended to five years after completion of construction. See Note 1A to Note 13 of Notes to Financial Statements for information as to the methods of accounting for multi-family projects.

At December 31, 1974, Leadership had the following apartment projects under construction of which only Las Vegas II is not subject to a contract of sale:

<u>Name and Location</u>	<u>No. of Units</u>	<u>First Occupied or Expected</u>
Meadow Road I		
Dallas, Texas .....	298	2/75
Irving III		
Dallas, Texas .....	316	4/75
Las Vegas II		
Las Vegas, Nevada .....	199	6/75

#### **Land Sales**

Leadership has acquired large parcels of unimproved land for its own use as well as for sale to other developers. In certain locations, it has acquired smaller parcels of improved land (see Item 3. "Properties" at p. 28).

A major source of financing of Leadership's land development has been borrowings from Real Estate Investment Trusts ("REITs"). During 1974, REITs experienced significant problems relating to high interest rates and liquidity, which prevented the REITs from providing financing for land development activities. As a result, potential buyers of Leadership's land, typically homebuilders, could not obtain financing for the purpose of making land purchases and developing such land.

As a result of the foregoing and the depressed state of the single family home market, Leadership's land sales declined from \$30 million in 1973 to \$2.9 million in 1974. It is not expected that land sales will return to previously existing levels until such time as there is a general improvement in the housing industry, and including an increase in the availability of funds for development at lower rates of interest than generally prevailed in 1974.

#### **Joint Ventures**

Leadership currently has an interest in four ventures with investors. The first is a partnership agreement relating to approximately 1,600 acres in Palm Beach County, Florida. Leadership manages, on behalf of the partnership and for a fee, the development and ultimate sales of this tract for 50% of the profits (but not losses) on approximately two-thirds of the property, and shares equally in profits and losses on the balance. Sales by the foregoing partnership resulted in a pre-tax profit to Leadership of approximately \$1.6 million in 1974 compared to approximately \$4.2 million in 1973.

The second venture, in the City of Tamarac, Florida, is with a group of private trusts of which members of the Pritzker family, including Messrs. Jay A. Pritzker and Robert A. Pritzker, are the beneficiaries. The venture was formed in December 1972, at which time Leadership sold a large tract of unimproved building property to the trusts for an aggregate purchase price of approximately \$22,500,000 of which \$18,000,000 was paid in cash and the balance was paid by a note secured by a second mortgage on approximately 40% of the property.

Under the terms of the agreement, approximately 40% of the property, zoned for 6,141 dwelling units is to be improved and sold under the management of Leadership, with Leadership and the trusts sharing equally in net profits. During 1973 and the early part of 1974, property zoned for 1,014 dwelling units and a small parcel of property zoned for commercial use was sold to third parties resulting in a profit to Leadership of approximately \$657,000. In addition, during 1973 contracts were



entered into with third parties for the sale of property zoned for 1.720 dwelling units. At the present time, all of the foregoing parcels (other than the commercial property) are subject to claims for rescission for which, as of the date hereof, lawsuits had been either instituted or threatened. In addition, all of the foregoing property is the subject of litigation between Leadership and the trusts on the one hand and the City of Tamarac on the other, regarding zoning of the property. The litigation arose out of the annexation of the property by the City of Tamarac and an attempt by the City to rezone the property for a lower density than was applicable to the property at the time the contracts for the sale of such property were entered into. Leadership and the trusts were successful in the lower court but the suit is presently under appeal by the City of Tamarac. Leadership is unable to predict the results of the appeal, and the effect, if any, the results of such appeal will have on the rescission actions.

With respect to another 40% of the property, the agreement requires the trusts to pay for certain improvements to the property, and Leadership is required to repurchase portions of the property zoned to permit an aggregate of 4,500 housing units to be built on the repurchased property. Such repurchases are to be effected in substantially equal amounts by June 30 of each year through 1979. The repurchase price is to consist of the purchase cost of the trusts, improvement costs, carrying charges and an additional amount equal to \$760 per unit for which the property is zoned. If Leadership fails to make the required repurchases, the agreement provides that the trusts may sell the properties and keep all profits. The agreement further provides that the trusts may set off against a purchase money second mortgage owing to Leadership the difference, if any, between the price at which the trusts sell the property and the price at which Leadership would have been required to repurchase the property. Based on Leadership's financial position, Leadership and the trusts amended the agreement to provide for a moratorium of the obligations of both parties for a period of one year. In addition, Leadership has an option to repurchase additional portions of the improved property zoned to permit approximately 2,700 units on the same terms as apply to the 4,500 unit tract. Pursuant to the terms of the amendment to the agreement, Leadership will surrender an option relating to parcels zoned for 753 units if such option is not exercised by June 30, 1975. During 1973 and 1974, Leadership repurchased property zoned for 1,770 units for an aggregate amount of approximately \$4,697,000. The balance of the property will be used for the construction of two eighteen-hole golf courses and a club house.

There are two ventures with a partnership in which members of the Pritzker family, including Messrs. Jay A. Pritzker and Robert A. Pritzker, have indirect interests, relating to parcels of 3,900 acres of property and 235 acres of property in Broward County, Florida. The ventures were formed in 1973, and call for Leadership to act as managing partner for the improvement and resale of the property, with Leadership and the partnership sharing equally in ultimate profits and losses in each of the ventures.

The ventures in which Messrs. Jay A. Pritzker and Robert A. Pritzker have interests were commenced at a time when neither was affiliated with Cerro.

#### **Water and Sewage Facilities**

Tamarac Utilities, Inc., a wholly owned subsidiary of Leadership, is located within the City of Tamarac, Florida. Operations are conducted under a 30-year non-exclusive franchise granted by the City allowing it to service customers directly in consideration of a payment by the utility to the City of an amount equal to 4 percent of the gross sales of the utility. In 1974, the utility had a loss of \$418,000. An application is presently pending before the Florida Public Service Commission for an increase in the rates the utility may charge its customers. During 1974, approximately \$4,763,000 was expended on plant and system expansion. In addition, the utility presently has a planned capital expenditure program which is estimated at \$3,300,000 through 1978. It is presently contemplated that funds for such capital expenditures may be provided by Cerro. The facilities are subject to regulation by the Florida Public Service Commission and the Florida State Board of Health.

## TRUCKING GROUP

Illinois-California Express, Inc., a Nebraska corporation ("ICX"), is a Class 1 common carrier of general commodities subject to regulation by the Interstate Commerce Commission ("ICC") and operates over 18,000 route miles in all or part of the states of California, Arizona, New Mexico, Texas, Utah, Colorado, Nebraska, Kansas, Missouri, Illinois, Iowa, Indiana, Ohio, Wyoming, Nevada, Oklahoma, Wisconsin, and Minnesota. Since its acquisition by Cerro in 1972, ICX expanded its operating authority through acquisition of the operating authorities of a number of small trucking companies. During 1974, ICX received temporary authority from the ICC to operate Bestway Freight Lines, Inc., which includes routes to such cities as Tulsa, Oklahoma City, and Wichita. In addition, during 1974, ICX received permanent authority from the ICC to operate Southern Express Company, previously operated by ICX under the temporary authority granted in 1973. As a result of the Southern Express acquisition, ICX extended routes directly covered by it from Chicago, Illinois, to the northern Ohio area, including the cities of Cleveland, Akron, Warren, and Toledo. ICX presently has applications pending before the ICC, which, if approved, will enlarge its service in the areas of Chicago, Illinois, and Phoenix, Arizona, and provide new routes between Omaha, Nebraska and Kansas City, Missouri. During 1974, ICX continued to be able to serve customers on a national basis through interchange agreements with various trucking companies whose authorities cover those portions of the United States for which ICX has no operating authority.

## MINING GROUP

### Acquisition of Fetterolf Coal Group

Cerro, on September 25, 1974, acquired, through its wholly owned subsidiary, Fetterolf Coal And Construction, Inc., at a cash cost of approximately \$34,000,000, the M. F. Fetterolf Coal Co., Inc. and its affiliates ("Fetterolf") which owns and leases operating properties in Somerset County, Pennsylvania containing coal reserves, principally of metallurgical grade. Fetterolf's principal holdings contain coal reserves as follows:

	Short Tons (2,000 pounds avoirdupois*)
Assured . . . . .	37,040,000
Probable . . . . .	1,407,000

\* Recoverable, washed basis.

In addition, Fetterolf owns or leases parcels of coal bearing land as to which no definitive studies have been made to determine assured and probable reserves.

In the fourth quarter of 1974, Fetterolf had pre-tax earnings of \$10.5 million on sales of \$21.1 million. 257,000 short tons of coal were sold in the period of which 158,000 tons were produced by Fetterolf and 99,000 tons represented coal purchased from others. Operations were interrupted during the quarter as a result of the United Mine Workers' strike which began on November 12, 1974 and continued until December 9, 1974.

Low volatile metallurgical coal of the type produced by Fetterolf is a commodity sold both domestically and abroad. As noted below, a substantial proportion of Fetterolf's production is dedicated to a long-term Coal Sales Agreement with two foreign corporations. The remaining production is sold on the spot market. Such spot-priced coal is subject to wide price fluctuation. The earnings of Fetterolf during the fourth quarter of 1974 were in large part a result of coal sold on the spot market at record levels. There can be no assurance that such price levels will continue and, indeed, in recent weeks spot prices for metallurgical coal, while still higher than those prevailing during the comparable period in 1974, have fallen substantially.

The demand for metallurgical coal is dependent upon the demand for steel and in particular the demand for steel made from iron ore since steel can be produced from scrap without the use of metallurgical coal.

As of October 1, 1974, Cerro's subsidiary, Fetterolf Coal And Construction, Inc., which owns 100% equity interest in Fetterolf, entered into a Coal Sales Agreement with two foreign corporations for the sale of metallurgical coal beginning July 1, 1975. Cerro's subsidiary is required to deliver and the buyers are obligated to accept 600,000 long tons (2,240 pounds avoirdupois) during the first nine months and one million long tons annually thereafter until March 31, 1988. The price is considered to be comparable to the prevailing market price for comparable quality coal sold under long-term contracts (considering the fact that unlike most other long-term contracts for similar coal, the price under the Coal Sales Agreement is firm for the life of the contract), and is subject to adjustment for increased or decreased costs and to maintain in part existing profit margins.

The price for coal sold under the Coal Sales Agreement is also subject to certain reductions for failure to meet specifications for ash and sulphur content determined by samplings to be taken from each shipment. The buyers under the Coal Sales Agreement may also reject coal not conforming to quality requirements in regard to ash and sulphur content if the coal shipped repeatedly fails to conform to these requirements until the buyers have received adequate assurance based on testing results that the coal tendered for delivery will meet content standards. If such coal fails to meet certain other specifications in two consecutive shipments, the buyers must accept such coal but only at a penalty to be negotiated. If the next succeeding shipment fails to meet such specifications, the buyers may reject such shipments unless a reduced price is negotiated. In the event of a failure to successfully negotiate such price, the buyers may terminate the Coal Sales Agreement.

On December 19, 1974, Cerro's subsidiary borrowed from the buyers under the Coal Sales Agreement \$35 million at an interest rate of 9.5% per annum. The loan is secured by certain of the assets of Fetterolf. Repayment of the loan is to be made in semi-annual installments over a ten-year period commencing December 20, 1977. Cerro has used a portion of the proceeds of the loan to finance the purchase of Fetterolf and will use the balance to expand the existing facilities as described below. Cerro has guaranteed delivery by its subsidiary of one million long tons of coal in the first full fiscal year of the Coal Sales Agreement. Cerro's subsidiary has the right under the loan agreement to suspend debt service for up to one year should it be unable to ship coal to the buyers as a result of an event of force majeure as set forth in the Coal Sales Agreement. In addition, damages resulting from a breach of the Coal Sales Agreement by the buyers may be offset against payments due under the loan agreement.

At the time of acquisition by Cerro's subsidiary, Fetterolf's underground and strip mining operations were able to produce approximately 650,000 short tons per annum. Expansions are now under way to increase mine production to 1.3 million short tons a year at an estimated capital cost of \$13.5 million.

Fetterolf owns or leases approximately 21,425 acres of coal lands located in western Pennsylvania. Under the terms of most of such deeds or leases Fetterolf has the right to remove and take title to coal in certain specified seams in such coal lands but usually does not have title or the right to possession of surface of such lands. In addition, in most cases the right to remove other minerals or coal from other seams has been reserved to the grantor. In addition, Fetterolf owns or leases surface rights to approximately 600 acres of land on which are located or are to be located existing or proposed mine mouths and various structures, such as offices, storage and work sheds, and the coal preparation plant referred to above. Management believes that the material deeds and leases held by Fetterolf are on terms sufficient for their intended uses.

At present, all of Fetterolf's underground mines are operated under contract by the G.M.&W. Coal Co. In order to assure a continued operation by a qualified underground mining organization, an option has been negotiated to purchase the G.M.&W. Coal Co. and its sister company, Delta Mining, Inc. for a net price of \$7.3 million.

The coal preparation plant at Boswell, Pennsylvania, which is also the location of Fetterolf's executive and administrative offices, can at present process coal sufficient to produce about 1 million short tons of clean coal per year. This facility is now in the process of being expanded to 1.4 million short

tons a year at a cost of \$1.2 million. Included in the work is a provision for new stacking and reclaiming equipment to facilitate the loading of railroad coal cars. The expanded coal preparation plant is expected to be fully operational by the end of 1975.

Coal produced by Fetterolf is transported primarily by rail and also by trucks. Rail cars are in short supply from time to time and the unavailability thereof could have an adverse impact upon Fetterolf's operations and its ability to comply with the Coal Sales Agreement.

Fetterolf competes with numerous producers, some of whom are substantially larger, and has only a small share of the market. In addition, there are large reserves of metallurgical coal owned by steel companies which may be brought into production if the price of metallurgical coal remains high.

Fetterolf is subject to State and Federal legislation prescribing mining health and safety standards. The Federal Coal Mine Health and Safety Act of 1969 ("the Act") imposes strict health and safety requirements and grants to Federal Mine Inspectors a great amount of discretion. Violation of the act may result in fines and/or criminal penalties and empowers the Bureau of Mines to close coal mining operations. While officials of Fetterolf believe they will be able to substantially comply with the Act, the standards and requirements imposed thereby are likely to result in significantly increased operating costs and capital investments.

Fetterolf's operations are subject to environmental regulations imposed by the Federal Government and the Government of the Commonwealth of Pennsylvania. Such regulations include water quality and surface mining regulations which affect operations at Fetterolf's mines. In addition, Fetterolf's underground mines are subject to regulations relating to subsidence of the surface as a result of undermining. Compliance with water quality regulations and surface mining regulations, (and in particular, requirements to reclaim strip-mined land) have and will result in substantially increased operating costs.

#### **Cerro Spar Corporation**

Cerro, through a subsidiary, Cerro Spar Corporation ("Cerrospar"), is the operator and manager of, and has a 70% interest in, a joint venture which began construction of a fluorspar mine and milling operation in western Kentucky in June 1972. The project was completed in mid-year 1974 at a cost to the venture of \$6.7 million.

Start up problems and certain underground mining conditions resulted in unsatisfactory operations in 1974. Once these problems are overcome, the mine is expected to produce at an annual rate of 56,000 tons of acid-grade fluorspar. Indicated and inferred ore reserves of the mine are believed sufficient for a mine life of nine years based on the stated rate of production. The two principal uses for fluorspar are in the production of hydrofluoric acid by the chemical industry and as a flux in the steel industry. Cerrospar expects to sell its product principally to the chemical industry.

The fluorspar business in the United States receives competition from both European and Mexican producers. However, Cerrospar's principal competition is from Mexico due to the shipping advantage over the European producers.

#### **Zidani Asbestos Mine Project**

In northern Greece, pilot-processing tests were concluded on asbestos ore from the Zidani asbestos deposit located near Kozani. The 1974 test work succeeded in establishing a specialized processing flow sheet particularly well adapted to Zidani ore. The results of all work performed at the property to date, together with up-to-date construction and operating costs as well as a revised financial projection, were assembled and incorporated into a techno-economic study which is now under review in Greece.

The mining rights to the Zidani asbestos deposit are held under long-term lease by a 71.25% owned Greek subsidiary of Cerro. The remaining interest is held by the Hellenic Industrial Development Bank S.A. ("ETBA"), an agency of the Greek Government, which provided funds for the field work and related studies performed in 1974.

The techno-economic study confirms the feasibility of developing and constructing facilities with capacity to produce 100,000 metric tons of milled chrysotile asbestos a year in commercially usable fiber groups. Total new funds required, including initial working capital but excluding approximately \$2 million expended on pre-construction expenses, were estimated in 1974 at \$45.4 million.

As now conceived, Cerro would retain a 51% equity interest in the Greek subsidiary and the remaining equity interest would be held by several Greek corporations, including ETBA, and possibly another investor. The Zidani property is believed to be well situated for supplying the markets for asbestos fiber in Europe, North Africa and the Middle East. Approximately 80% of the asbestos fiber which would be produced by the Greek subsidiary would be exported from Greece, and the remainder sold within Greece. A decision as to whether or not to proceed with this project is expected to be made in 1975 and will depend upon a number of factors, principally the availability of financing on acceptable terms.

## INVESTMENTS

### Southern Peru Copper Corporation

Cerro has a 22¼% interest in Southern Peru Copper Corporation ("S.P.C.C."). S.P.C.C. holds concessions covering two mines, Toqueñala, in operation, and Cuajone, under development, both located inland from the southern port city of Ilo, Peru.

In 1974 S.P.C.C. had sales of approximately \$187.9 million and net income of approximately \$40.5 million, compared with sales and net income in 1973 of approximately \$215.7 million and \$61.3 million, respectively. The decline in sales and income was principally due to lower copper prices and increased fuel costs.

S.P.C.C. entered into a bilateral agreement with the Peruvian Government dated December 19, 1969 as a result of which S.P.C.C. is developing the Cuajone orebody and constructing ancillary facilities. The complete cost of this project is estimated to be approximately \$620 million, including \$70 million of interest charges to be capitalized during construction. At December 31, 1974, \$345 million had been invested, primarily from cash throwoff from S.P.C.C.'s operations. In 1972 S.P.C.C. suspended dividend payments to permit such re-investment.

The bilateral agreement requires minimum annual expenditures and the entire project must be completed by December 1976 but may be extended beyond that time for delays covered by force majeure. The bilateral agreement provides that failure to maintain the investment program or complete the project as scheduled in the absence of force majeure will result in termination of the concession for the Cuajone mine.

S.P.C.C. announced on January 5, 1975 that funds for completion of the project will become available in 1975 under loan agreements totalling \$404 million and involving 54 different lending institutions. In connection with such loan agreements, Cerro and the other stockholders of S.P.C.C. incurred certain contingent liabilities, as set forth below.

A Peruvian joint venture was established to operate the project. S.P.C.C. (with equity of 88.4%) will manage the project while Billiton, N.V. (a Netherlands company with 11.6% equity) will assign senior engineers to S.P.C.C. for work on project development and on subsequent mining and production operations.

Cuajone is scheduled for start up late in 1976 with an annual production capacity of 170,000 short tons of blister copper. Reserves are estimated at 468,000,000 tons of sulphide ore averaging slightly over 1% copper.

In connection with such financing arrangements, upon commencement of production from the Cuajone deposit, estimated for late 1976, Cerro could, in the event of the occurrence of certain contingencies not under the control of S.P.C.C., be required to return all or part of any cash dividends which may be paid by S.P.C.C. to Cerro during the period commencing six months prior to such commencement of production by S.P.C.C. at Cuajone, and continuing approximately until certain loans involved in such financing arrangements are repaid. Such repayment must be completed by 1987. In addition, Cerro would also be liable during the period of recoupment of S.P.C.C.'s investment in the Cuajone project to pay for the value of certain blister copper from such project contracted to be purchased by Cerro from S.P.C.C. even though such copper may not be delivered; as a result of this contractual provision, Cerro's maximum liability is estimated not to exceed \$5,000,000. Recently, certain stockholders of S.P.C.C. arranged for an option to place in effect on or before October, 1976, insurance against the foregoing contingent liabilities with Lloyds' Underwriters for a period of one year. Cerro's share of the face amount of such insurance is approximately \$1.8 million and its share of the cost of the option and premium is approximately \$50,000.

### Chile

On July 16, 1971, the Government of Chile nationalized the major American copper mining operations in the country, including Compañia Minera Andina S.A., a Chilean corporation ("Andina"), 70% owned by Cerro with the remaining 30% owned by Corporacion del Cobre ("Codelco"), a Chilean Government agency. Andina owned and operated the Rio Blanco copper mine which came into commercial production at the time of the nationalization.

The total investment of Cerro in Andina consisted of approximately \$14,700,000 of equity contributions and \$21,000,000 in loans (including accrued interest and miscellaneous items) evidenced by subordinated notes payable by Andina. In addition, as of February 28, 1974 Andina owed Cerro approximately \$5,600,000 in interest on such notes which had not been recorded by Cerro.

As of February 28, 1974, the Government of Chile issued decrees and the Government and Cerro signed agreements providing for compensation for the expropriation of Andina.

Under these compensation arrangements, Cerro received a cash payment at the time of signing, in the amount of \$3,223,000 and a total of \$38,633,794 in two series (Series A and Series B) of serial notes payable semi-annually to start September 1, 1974 and to terminate on September 1, 1990. The notes bear interest at 9.165% per annum, free of Chilean taxes and are guaranteed by the Central Bank of Chile. Payments (including interest) on the notes due on September 1, 1974 and March 1, 1975, each in the amount of \$2,700,000 were duly received.

Cerro now reflects its former investment in Andina in Notes Receivable.

In addition, Cerro has the right to the proceeds from certain copper bearing materials produced in Chile, which cannot be processed in Chile and which are outside normal Chilean production and exports. Under this arrangement, as Cerro locates buyers for these materials, the proceeds are applied to the prepayment of the notes (pari-passu as between Series A and Series B), in inverse order of maturity. Notes to be so prepaid are discounted at a rate of 9% per annum from the normal due date to the date of such prepayment. Cerro has the right to materials of this type to the extent available until the full amount of the notes has been paid. Cerro's interest in this material is for the sole purpose of accelerating prepayment of the indebtedness and Cerro will not derive additional revenues from such materials.

Through March 21, 1975, Cerro had collected \$5.6 million in prepayments and \$5.4 million in payment of regular maturities. The most remote maturity outstanding on both Series of notes is now March 1, 1984.

On July 16, 1974, Cerro entered into a Guaranty Agreement with Overseas Private Investment Corporation whereby the latter agreed to guarantee \$12.1 million of Series B notes. The guarantee applies to each of the Series B notes, pro rata, with interest at 7.26% and it is reduced as each of the notes is paid.

#### **Peruvian Affiliates**

In 1974, Cerro received net dividends of \$782,000 from its Peruvian industrial and mining affiliates and an additional \$334,000 in net dividends from its consolidated subsidiary, Industrias de Cobre, S.A., a manufacturer of electrical wire and cable. In 1973, Cerro fully reserved for its entire investment in those affiliates and the subsidiary.

#### **Compensation for Expropriation of Cerro de Pasco Corporation**

In December 1974, Cerro received from the United States Government \$10.0 million plus interest, representing the final installment of the \$68.0 million paid by Peru as compensation for expropriation of Cerro de Pasco Corporation. The \$10.0 million had been paid to the United States by Peru in February 1974.

#### **Savage River Corporation (Northwest Iron Co. Ltd.)**

Through its 24% equity position in Northwest Iron Co., Ltd. ("Northwest"), Cerro holds an approximate 12% interest in Savage River Corporation, a joint venture operating iron mining and pelletizing facilities in Tasmania, Australia. Besides Cerro, the owners of Northwest include Pickands Mather & Co. as operator and 48% owner with the balance distributed among a number of institutional investors.

Cerro and Pickands Mather & Co. have agreed to advance sufficient funds to maintain Northwest's working capital at a level of \$500,000 until certain of its outstanding indebtedness, totalling approximately \$31 million, has been repaid; such repayment is scheduled for 1983. Cerro advanced \$247,000 in 1971 for this purpose. No advances were required in 1972, 1973 or 1974. Cerro's share of the owners' contingent liability amounted to approximately \$7.3 million at December 31, 1974 as compared with \$8.8 million at December 31, 1973.

In 1974, Northwest reported net income of \$1.9 million, including an extraordinary credit of \$900,000 on net sales of \$16.8 million. In 1973 Northwest recorded net income of \$1.8 million, including an extraordinary credit of \$800,000, on net sales of \$13.3 million.

In 1973, Cerro fully reserved for its investment in Northwest.

### **(b) COMPETITION, BACKLOG, MATERIALS AND SUPPLIES, FRANCHISES, RESEARCH, EMPLOYEES AND ENVIRONMENT\***

#### **(1) Competition**

**Manufacturing Group** — The fields in which Cerro's manufacturing divisions operate are intensely competitive. Although Cerro is a major producer in its fields, a number of the major competitors of Cerro are fully integrated and have captive sources of copper which equal or exceed their fabricating and manufacturing capacities. Each of Cerro's manufacturing divisions is dependent on non-captive sources of supply.

(a) **Cerrocu** — There are approximately 25 primary and redraw domestic copper tube companies with which Cerrocu competes. All of these companies have capacity substantially in excess of demand, a condition aggravated by substantially reduced demand in the second half of 1974. Cerrocu attempts

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\* For a discussion of these matters as they affect the Mining Group, see the text under the heading "Mining Group" at p. 10.

to compete in the areas of price and service by maintaining regional warehouses for its product lines and using its own sales force. In the sale of electrolytic copper cathodes, Cerrocu competes with all copper refiners.

(b) *Cerrowire* — There are a large number of competitors with which Cerrowire competes, no one of which necessarily produces the same product line. Therefore, its competitive position varies with each type of wire and cable produced by this division. Generally, conditions continued to be highly competitive in 1974, particularly during the last quarter of the year.

(c) *Cerrocom* — There are approximately 6 major competitors with which Cerrocom competes, no one of which necessarily produces the same product line. Therefore, its competitive position varies with each product produced by this division. Generally, conditions continued to be highly competitive in 1974, particularly during the last quarter of the year.

(d) *Cerromet* — There are 7 major competitors producing substantially similar products as Cerromet as well as over 100 foreign and domestic companies competing in various lesser degrees with all products produced by this division. The division competes on the basis of quality of its products and advantageous geographic locations. During the second half of 1974, the division experienced a substantial decrease in demand for its rod and fabricated parts products. This decrease in demand has not yet abated.

(e) *Golconda* — Golconda is subject to intense competition from a large number of firms in each of the fields in which it is engaged. Competition varies from older and larger firms having greater financial resources than Golconda to small local and regional competitors which have advantages deriving from proximity to local markets.

*Real Estate Group* — The housing industry is highly competitive. Leadership is one of many national home builders and competes with numerous builders (national, regional and local) of both single and multi-family residences in every area where its developments are located. Competition is based primarily on design, location and price. Although it is impractical to estimate the number of companies with which Leadership competes, there are competitors which are larger, more experienced and have greater financial resources.

Generally the single family developments in Florida have been designed as "adult communities" and homes were typically sold to retired individuals living on fixed incomes. During 1974, the ability of such persons to obtain mortgages was impaired by the high interest rates, as well as their ability to find buyers for the homes they were living in, prior to moving to Florida. Recently, Leadership has attempted to increase its market in Florida for sale to younger families.

*Trucking Group* — Competition for freight, within the geographic market in which ICX operates, is intense from competing trucking companies as well as other modes of transportation. Based on the latest available industry statistics, ICX was among the 50 largest General Commodities Common Carriers in terms of gross revenues.

## (2) Principal Customers

Neither of the Manufacturing, Real Estate, nor Trucking groups is dependent on a single customer, or a small number of customers, the loss of which would have a materially adverse effect on any such group.

## (3) Backlog of Orders

The dollar backlog of orders believed to be firm at December 31, 1974 was substantially reduced from that at December 31, 1973, particularly in the Manufacturing Group; with the exception of the



New Haven plant of Cerrowire, however, the amounts of such orders are not considered significant to an understanding of any of the principal groups of Cerro, other than the Real Estate Group. As at December 31, 1974 the New Haven plant had a backlog of orders believed to be firm of \$18.6 million compared with \$7.4 million at December 31, 1973. As at December 31, 1974, Leadership had a backlog of orders for single family homes believed to be firm amounting to \$16 million compared with \$62 million at December 31, 1973. As a common carrier, ICX has no long term agreements with customers, and therefore has no backlog of orders.

#### (4) Sources and Availability of Raw Materials

*Manufacturing Group* — Cerro's Manufacturing Group depends for raw materials (principally copper) used in production of copper and brass mill products, electrical wire and cable products on non-captive sources of supply, including purchases from United States, Canadian and other foreign producers of primary copper, from Cerrosales, from scrap dealers and customer generated scrap. Copper produced by the expropriated operations in Peru was not recently used as a major source of copper for Cerro's manufacturing operations, and therefore the loss of Cerro de Pasco Corporation has not had a direct effect on the availability of supplies for the Manufacturing Group. Copper is purchased in the United States at U.S. producer prices, at dealer prices and at scrap prices.

A renewal of the fuel shortage could result in a significant increase in all energy costs and in the costs of materials produced by the petro-chemical industry. The Cerrowire and Cerrocom divisions use a substantial amount of petro-chemical products such as polyethylene, neoprene and polyvinyl chloride in the manufacture of its wire and cable. Renewal of a shortage of such products as occurred in the last half of 1973 could again cause some curtailment of output. Production of wire and cable was somewhat curtailed during the first nine months of 1974 because of a shortage of raw materials, primarily copper, steel, plastic resins and plasticizers.

*Real Estate Group* — Leadership is dependent for construction materials on independent local and regional suppliers in the building supplies business. During 1973 and the early part of 1974, Leadership experienced periods in which certain construction materials were either in short supply or not available at the times required by it. During 1973 Leadership instituted a policy of stockpiling those materials critical to scheduled construction in order to offset the effect of periodic shortages. During 1974 supplies required by Leadership were provided from material previously stockpiled and from its regular sources of supply. In 1974, therefore, Leadership encountered no shortages of materials. However, the cost of virtually all the materials used by Leadership increased substantially, and because of existing contracts, Leadership, in most instances, was unable to pass on such cost increases to its buyers.

*Trucking Group* — ICX operates both diesel and gasoline fueled trucks. The primary source of fuel is the major oil companies and some independent oil suppliers. In order to avoid the effects of temporary fuel shortages, during 1974 ICX added storage capacity for the purpose of maintaining an adequate supply of fuel. In addition, two transport tankers were purchased for the purpose of moving fuel into areas of short supply. The cost of the foregoing was not material to ICX. The impact of fuel rationing and/or the imposition of levies on foreign oil cannot be predicted at this time.

The cost of fuel continued to increase during 1974 so that such costs aggregated approximately 5.4 percent of ICX's total costs for 1974, as compared with approximately 3.1 percent for 1973. During the first half of 1974 rate relief was granted in the form of a temporary surcharge, and permanent rate increases were granted during the year. However, such increases were not adequate to offset completely the increases in fuel and labor costs.

#### (5) Licenses, Patents and Trademarks

Cerro has no material patents, trademarks, licenses, franchises or concessions held which are important to its business, except in the case of ICX, which operates under the regulation of the Interstate Commerce Commission and various State regulatory agencies. ICX believes that it is in compliance with all authorities, franchises and licenses granted by all applicable regulatory agencies.

(6) Research and Development; Exploration

Cerro expended a total of approximately \$700,000 in 1974 and approximately \$900,000 in 1973 in mineral exploration activities and research and development in respect of new products and improvements of existing products. All of the foregoing expenses were company sponsored.

(7) Environmental Matters

Compliance with Federal, State and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment is not expected to have any material effect upon the capital expenditure, earnings and competitive positions of Cerro's Manufacturing Group, its Real Estate Group or its Trucking Group.

(8) Employees

As at December 31, 1974, Cerro had a total of 8,579 employees.

(c) INFORMATION AS TO CONTINUING LINES OF BUSINESS

The sources of Cerro's sales and earnings (losses) from continuing operations, before allocation of corporate administrative expenses and interest expense and before income taxes and extraordinary items, in each of the past five years were approximately as follows:

	Sales				
	1974	1973	1972	1971	1970
	(\$ in Thousands)				
Metal manufacturing .....	\$567,412	\$417,802	\$301,597	\$273,455	\$300,761
Real estate .....	96,006	159,949	114,668	52,634	21,388(1)
Trucking .....	73,466	58,856	11,756(1)	—	—
Mining .....	21,446(1)	—	—	—	—
	<u>\$758,330</u>	<u>\$636,607</u>	<u>\$428,021</u>	<u>\$326,089</u>	<u>\$322,149</u>

	Earnings (Losses) from Continuing Operations				
	1974	1973	1972	1971	1970
	(\$ in Thousands)				
Metal manufacturing .....	\$ 46,414	\$ 34,111	\$ 18,584	\$ 9,793	\$ 6,175
Real estate .....	(13,606)	11,884	5,609	(2,879)	(696)(1)
Trucking .....	4,970	5,550	1,183(1)	—	—
Mining .....	10,230(1)	—	—	—	—
Dividends from Southern Peru Copper Corp. ....	—	—	3,482	6,615	7,834
Other .....	11,177	4,698	2,170	2,670	3,046
	<u>\$ 59,185</u>	<u>\$ 56,243</u>	<u>\$ 31,028</u>	<u>\$ 16,199</u>	<u>\$ 16,359</u>

(1) Year of acquisition or start up.

The lines of business above are grouped based upon the raw materials utilized, products produced or services rendered.

## ITEM 2. SUMMARY OF OPERATIONS

The following sets forth the consolidated statement of earnings of Cerro Corporation and Consolidated Subsidiaries for the years 1970 through 1974:

	(\$ in Thousands)				
	1974	1973	1972	1971	1970
			(Not covered by Auditors' Report)		
Net sales	\$758,330	\$636,607	\$428,021	\$326,089	\$322,149
Other revenue, net (Note B)	23,571	21,268	14,817	16,786	14,776
	<u>781,901</u>	<u>657,875</u>	<u>442,838</u>	<u>342,875</u>	<u>336,925</u>
Cost of products sold	661,886	549,832	373,277	300,713	303,996
Selling and administrative expenses	57,206	58,933	38,364	32,477	20,887
Interest cost accrued	23,301	17,596	13,336	8,427	5,329
Less: Interest capitalized (Note I)	(8,461)	(5,962)	(3,558)	(2,490)	(1,086)
Depreciation and amortization	8,692	8,722	4,845	3,679	3,810
	<u>742,624</u>	<u>627,121</u>	<u>426,264</u>	<u>342,806</u>	<u>332,936</u>
Earnings from continuing operations before taxes	39,277	30,754	16,574	69	3,989
Income taxes (Note C)	(23,350)	(15,376)	(7,512)	2,210	756
Earnings from continuing operations	<u>15,927</u>	<u>15,378</u>	<u>9,062</u>	<u>2,279</u>	<u>4,745</u>
Earnings from discontinued operations (Notes C and D)	—	33,783	10,626	353	12,221
Earnings before extraordinary items	<u>15,927</u>	<u>49,161</u>	<u>19,688</u>	<u>2,632</u>	<u>16,966</u>
Extraordinary items (Notes C, D and E)	—	(45,550)	(1,924)	(988)	(2,886)
Net earnings	<u>\$ 15,927</u>	<u>\$ 3,611</u>	<u>\$ 17,764</u>	<u>\$ 1,644</u>	<u>\$ 14,080</u>
Earnings per Common Share (in dollars)*:					
Continuing operations	\$2.01	\$1.86	\$1.07	\$ .27	\$ .56
Discontinued operations	—	4.08	1.26	.04	1.43
Earnings before extraordinary items	<u>2.01</u>	<u>5.94</u>	<u>2.33</u>	<u>.31</u>	<u>1.99</u>
Extraordinary items	—	(5.50)	(.23)	(.12)	(.34)
Net earnings	<u>\$2.01</u>	<u>\$ .44</u>	<u>\$2.10</u>	<u>\$ .19</u>	<u>\$1.65</u>
Dividends (represents historical dividends paid):					
Cash	\$1.05	\$ .75	\$ .60	\$ .80	\$1.60
Stock	—	—	—	5%	5%
* Based on the weighted average number of shares outstanding during each year as adjusted for stock dividends (Thousands of shares) (Note J)	<u>7,925</u>	<u>8,273</u>	<u>8,464</u>	<u>8,463</u>	<u>8,511</u>

See Notes to Financial Statements (numerical references) and  
Notes to Summary of Operations (alphabetical references)

# CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

## CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	Years Ended December 31				
	1974	1973	1972	1971	1970
			(Not covered by Auditors' Report)		
			(\$ in Thousands)		
Balance at beginning of year	\$154,323	\$103,939	\$ 90,750	\$103,179	\$112,591
Add:					
Reappraisal surplus (Note 11)	—	52,959	—	—	—
Consolidation adjustments related to minority shareholders' equity in Leadership Housing, Inc.	—	—	503	—	—
Net earnings	15,927	3,611	17,764	1,644	14,080
Cash dividends	(8,315)	(6,186)	(5,078)	(6,770)	(12,965)
Transferred to common stock and paid-in capital for 5% stock dividend	—	—	—	(7,303)	(10,527)
Balance at end of year	<u>\$161,935</u>	<u>\$154,323</u>	<u>\$103,939</u>	<u>\$ 90,750</u>	<u>\$103,179</u>

## CONSOLIDATED STATEMENT OF PAID-IN CAPITAL

	Years Ended December 31				
	1974	1973	1972	1971	1970
			(Not covered by Auditors' Report)		
			(\$ in Thousands)		
Balance at beginning of year	\$178,218	\$178,084	\$178,084	\$172,159	\$162,916
Excess of fair value over par value of common stock issued as stock dividends, (1970 — 397,228 shares; 1971 — 417,291 shares)	—	—	—	5,912	9,202
Excess of cash received over par value of common stock issued upon exercise of stock options (1970 — 4,049 shares; 1971 — 1,118 shares; 1973 — 15,407 shares)	—	134	—	13	41
Balance at end of year	<u>\$178,218</u>	<u>\$178,218</u>	<u>\$178,084</u>	<u>\$178,084</u>	<u>\$172,159</u>

See Notes to Financial Statements (numerical references)  
and Notes to Summary of Operations (alphabetical references)

# NOTES TO SUMMARY OF OPERATIONS

## A. Consistency of Accounting

Extraordinary items for the years 1970-1972 include items which under the provisions of Accounting Principles Board Opinion 30, effective in October 1973, would have been included in the determination of earnings from continuing operations or from discontinued operations. Opinion 30, however, prohibits restating prior year financial statements for consistency with 1973 and subsequent periods. Had the accompanying Summary of Operations been restated, however, earnings would have been as follows:

	(\$ in Thousands)		
	1972	1971	1970
Earnings (loss) from continuing operations	\$ 7,412	(\$ 519)	\$ 3,183
Earnings from discontinued operations .....	7,550	353	10,897
Extraordinary items .....	2,802	1,810	—
Net earnings .....	<u>\$17,764</u>	<u>\$1,644</u>	<u>\$14,080</u>

Net earnings as reported in the Summary of Operations are unchanged.

## B. Other Revenue, Net

In addition to other items, other revenue, net includes dividends from Southern Peru Copper Corporation, a 22 1/4 %-owned affiliate, accounted for on the cost basis, and the following:

	(\$ in Thousands)				
	1974	1973	1972	1971	1970
Southern Peru Copper Corporation	\$ —	\$ —	\$3,482	\$6,615	\$7,834
Interest on marketable securities ..	\$ 6,154	\$4,244	\$1,249	\$1,366	\$ 939
Other interest income .....	\$10,662(1)	\$5,863	\$4,030	\$1,807	\$ 211
Joint venture income .....	\$ 1,883	\$4,252	\$ —	\$ —	\$ —

(1) Includes in 1974, \$2,878,000 applicable to the Chilean Notes and \$526,000 relating to the receivable from the U.S. Government.

## C. Income Taxes

Income tax expense (benefit) consists of the following:

	(\$ in Thousands)				
( ) = benefit	1974	1973	1972	1971	1970
Currently payable:					
United States .....	\$ 2,312*	\$ 4,618	(\$ 236)	(\$3,255)	(\$ 356)
Foreign .....	607	36,788	6,591	389	8,746
State .....	4,201	842	1,475	846	1,429
Deferred:					
United States .....	(10,273)	10,020	(844)	(351)	(3,111)
Foreign .....	—	—	1,372	820	2,229
Future tax benefit .....	26,503	(64,800)	—	—	—
	<u>\$23,350</u>	<u>(\$12,532)</u>	<u>\$8,358</u>	<u>(\$1,551)</u>	<u>\$ 8,937</u>

\* Adjustment in 1974 to conform to 1973 tax return as filed.

Income-tax expense (benefit) has been allocated as follows:

	(\$ in Thousands)				
	1974	1973	1972	1971	1970
Earnings from continuing operations:					
United States .....	\$18,542	\$14,534	\$6,037	(\$3,056)	(\$ 2,185)
State and foreign .....	4,808	842	1,475	846	1,429
	<u>23,350</u>	<u>15,376</u>	<u>7,512</u>	<u>(2,210)</u>	<u>(756)</u>
Earnings from discontinued operations .....	—	36,892	3,709	474	10,975
Extraordinary items .....	—	(64,800)	(2,863)	185	(1,282)
	<u>\$23,350</u>	<u>(\$12,532)</u>	<u>\$8,358</u>	<u>(\$1,551)</u>	<u>\$ 8,937</u>

For financial statement purposes, the full tax benefit of \$64,800,000 applicable to the Cerro de Pasco expropriation loss (Note E) was recognized in 1973 because of the non-recurring nature of the loss and Cerro's virtual certainty of utilizing such benefit over the carry-forward period allowed by the tax statutes. Cerro's future tax liability will be reduced by the expropriation loss tax benefit.

Deferred tax expense results from timing differences in the recognition of revenue and expense for tax and financial statement purposes. The sources of timing differences in 1973 and the tax effect of each were as follows (\$ in Thousands):

Real estate operations — principally use of installment sales method for tax purposes and deduction of interest costs which are capitalized for financial statement purposes .....	\$ 8,922
Financial statement expenses — principally reserves for investments and expenses not currently deductible for income tax purposes .....	(5,393)
Income taxed in prior years and recognized currently for financial statement purposes .....	4,903
Other, net .....	1,588
	<u>\$10,020</u>

The deferred tax liability at December 31, 1973 was eliminated in 1974 as a result of the expropriation loss.

The 1974 tax provision of \$23,350,000 represented an effective tax rate of 59.4% as follows:

	Percent of Pre-Tax Income
Computed "expected" federal tax rate .....	48.0%
Capital losses with no current tax benefit .....	3.3
Goodwill amortization not deductible for tax purposes .....	1.8
State and local income taxes net of Federal income tax benefit .....	5.6
Other, net .....	0.7
Tax provision .....	<u>59.4%</u>

The 1973 tax provision of \$15,376,000 represents an effective tax rate of 50.0% of pre-tax earnings from continuing operations.

#### D. Discontinued Operations

The table below shows the profits or losses that were recorded from operations that have been expropriated, sold or liquidated.

	(\$ in Thousands)			
	1973	1972	1971	1970
Income (loss) from operations of discontinued businesses, net of applicable income tax:				
Cerro de Pasco .....	\$30,111	\$13,740	(\$ 429)	\$11,669
Atlantic Cement .....	1,556	1,469	1,435	552
Stereo Tape Club .....	—	(4,583)	(653)	—
Gain on sale of investment in Atlantic Cement .....	2,116	—	—	—
Total .....	<u>\$33,783</u>	<u>\$10,626</u>	<u>\$ 353</u>	<u>\$12,221</u>

#### CERRO DE PASCO CORPORATION

The Government of Peru expropriated Cerro's wholly-owned subsidiary, Cerro de Pasco Corporation (Cerro-Peru) which resulted in a financial statement loss, after compensation but before tax benefit, of \$110,350,000 in 1973. The tax loss on the expropriation after adjusting the financial statement loss primarily for non-tax deductible pensions and severance reserves was approximately \$135,000,000. On February 19, 1974, based on an agreement between the Governments of Peru and the United States, Cerro received \$58,000,000, including repatriation of 1973's net earnings from Peru. The net after tax loss from expropriation, reflected as an extraordinary item in the accompanying 1973 financial statements, is \$45,550,000 or \$5.50 a share (Note E). In December 1974, Cerro received a final payment of \$10,000,000 with interest of \$526,000 from funds paid by Peru to the U.S. Government as part of a lump sum settlement agreed by the U.S. and Peru.

#### ATLANTIC CEMENT COMPANY, INC. (ATLANTIC)

In June 1973, Cerro sold its 50% interest in Atlantic for \$38,500,000 resulting in a gain of \$2,116,000. Cerro's equity in net earnings through the date of the sale was \$1,556,000.

#### STEREO TAPE CLUB OF AMERICA (STEREO)

The operations of Stereo had been unprofitable since its acquisition and in December 1972 Cerro ordered termination of the business and liquidation of its assets.

#### E. Extraordinary Items

The following table shows the extraordinary items reflected in the Summary of Operations:

	(\$ in Thousands)			
	1973	1972	1971	1970
Expropriation of Cerro-Peru* (Note D) .....	(\$45,550)			
Write off of:				
Stereo Tape Club of America* .....	—	(\$3,076)		
Goodwill at Cleveland, Ohio copper plant .....	—	—	(\$3,267)	
Undeveloped mining concessions in Peru* .....	—	—	—	(\$1,324)
Write down of investment in Texas International Petroleum Corporation .....	—	—	—	(882)
Net loss on disposal of machinery and equipment at Stamford, Connecticut plant* .....	—	—	—	(680)
Reserve for investments .....	—	(1,650)	(1,159)	—

	(\$ in Thousands)			
	1973	1972	1971	1970
Gain on insured casualty loss and sale of distribution station by Atlantic Cement .....	—	—	526	—
Gain on sale of mining concessions and oil leaseholds* .....	—	—	1,102	—
Utilization of net operating loss carry-forwards .....	—	2,802	1,810	—
	<u>(\$45,550)</u>	<u>(\$1,924)</u>	<u>(\$ 988)</u>	<u>(\$2,886)</u>
Per share (in dollars) .....	<u>(\$5.50)</u>	<u>(\$ .23)</u>	<u>(\$ .12)</u>	<u>(\$ .34)</u>

\* Net of taxes.

#### F. Business Combinations

During 1972, Cerro acquired approximately 80% of the outstanding stock of Behring Corporation, which through a subsequent merger into a wholly owned subsidiary, became Leadership Housing, Inc. In 1973, Cerro acquired all of the remaining outstanding shares of Leadership. The total cost of these transactions was approximately \$27,700,000, principally cash. The excess of the purchase price over the book value of the shares acquired has been allocated equally to land and goodwill. The goodwill portion is being amortized over forty years.

On October 6, 1972, Cerro acquired all of the outstanding common stock of ICX for \$21,501,000 paid in cash. The cost in excess of net assets acquired (\$11,859,000) has been assigned to operating rights and is being amortized over a forty year period.

On March 29, 1974, Cerro acquired 1,043,566 shares of common stock of Golconda Corporation (Golconda) for cash of \$9,753,000 and an additional 22,100 shares of common stock on April 19, 1974 for cash of \$180,000. On May 3, 1974, Cerro commenced a tender offer to purchase all the remaining outstanding common stock of Golconda at \$8.375 per share net to the seller and all of the cumulative preferred stock at \$16.25 per share net to the seller. As a result of the tender offer, which expired on May 29, 1974, Cerro acquired 1,345,759 shares of common stock and 281,635 shares of the cumulative preferred stock at a cost of \$16,600,000. In the aggregate, Cerro owns 86.6% of the common stock, 73.5% of the cumulative preferred, which is entitled to one vote per share, or 84.98% of the total outstanding voting shares. The total cost of \$26,600,000 has been allocated to the net assets of Golconda.

On September 25, 1974, Cerro through its newly established wholly owned subsidiary, Fetterolf Coal And Construction, Inc., acquired the outstanding stock of M.F. Land Company, Inc., M. F. Fetterolf Coal Company, Inc. and the partnership interests of D&F Trucking Company, collectively referred to as the Fetterolf Coal Group. The purchase price, which amounted to \$33,995,000 in cash, has been allocated to the net assets of the acquired Companies, principally coal mining properties.

These transactions were accounted for as purchases and the operating results of the acquired companies were included in Cerro's earnings from the respective dates of acquisition.

Had the acquisition of Behring (Leadership) and ICX been consummated on January 1, 1971 and Golconda and Fetterolf on January 1, 1973, the pro forma combined operating results of Cerro and these companies for 1971-1974 would have been as follows:

	(\$ in Thousands)							
	1974		1973		1972		1971	
	Total	Per Share	Amount	Per Share	Amount	Per Share	Amount	Per Share
Sales and other revenue .....	\$834,784	\$ —	\$724,065	\$ —	\$482,477	\$ —	\$419,303	\$ —
Earnings from continuing operations .....	\$ 23,936	\$3.02	\$ 18,010	\$2.17	\$ 10,593	\$1.25	\$ 3,151	\$ .37
Discontinued operations .....	—	—	33,783	4.08	10,626	1.26	(6,005)	(.71)
Extraordinary items .....	—	—	(45,550)	(5.50)	(1,750)	(.21)	(7,098)	(.84)
Net earnings .....	<u>\$ 23,936</u>	<u>\$3.02</u>	<u>\$ 6,243</u>	<u>\$ .75</u>	<u>\$19,469</u>	<u>\$2.30</u>	<u>(\$ 9,952)</u>	<u>(\$1.18)</u>



### G. Pension Expense

Pension expense charged to earnings from continuing operations was \$4,522,000, \$3,162,000, \$1,970,000, \$1,553,000 and \$1,338,000 for the years 1974 to 1970, respectively.

### H. Supplementary Earnings Statement Information

Supplementary earnings statement information is as follows:

	(\$ in Thousands)	
	1974	1973
Maintenance and repairs .....	\$12,448	\$12,209
Depreciation and amortization of property, plant and equipment ..	8,692	6,722
Taxes, other than income taxes .....	12,569	10,049
Rents .....	8,987	5,716

NOTE: Royalties, advertising, exploration, research and product development costs were not significant in amount.

### I. Interest Capitalization

It has been the practice of Cerro's real estate group to capitalize interest relating to obligations incurred in connection with land, construction and land improvements. Management believes this policy results in the most appropriate matching of costs and revenues. Had Cerro followed the policy of expensing all interest as incurred, its consolidated net earnings would have been as follows:

	Net Earnings	Per Share
1974 .....	\$13,717	\$1.73
1973 .....	2,052	.25
1972 .....	17,372	2.05
1971 .....	1,129	.13
1970 .....	13,522	1.59

### J. Earnings Per Share

Outstanding stock options have not been considered in the computation of earnings per share. Consideration of options would have resulted in less than 1% dilution or would have had an anti-dilutive effect on earnings per share.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

### 1971 vs. 1970

Cerro's metal manufacturing sales and profit margins in 1971 were affected by sharp declines in free world copper prices from 82¢ per pound in 1970 to a low of 45¢ in 1971. Pre-tax earnings were \$9,793,000 compared to \$6,175,000 in 1970. Brass mill profits were also depressed by declining demand and facilities operating below capacity in the early part of 1971.

Dividends from Southern Peru Copper Corporation (22¼% owned by Cerro) were \$6,615,000 in 1971 compared to \$7,834,000 in 1970. These dividends were subject to a relatively low rate of United States income tax.

In June 1971, Cerro acquired Stereo Tape Club of America. A net loss of \$653,000 was sustained by this operation during the period June 1, 1971 to December 31, 1971.

The adoption and use in 1971 of more conservative accounting policies in the determination of income from real estate transactions resulted in a pre-tax loss of \$2,879,000 for Cerro's wholly owned subsidiary, Leadership Housing Systems, Inc., which had completed its first full year of operations. Sales in 1971 were \$52,634,000 versus \$21,368,000 in the last quarter of 1970.

For the year 1971, a tax benefit of \$3,056,000 was recognized for U.S. income tax purposes through the carry-back of losses to a prior year. Such losses relate principally to deductions from book income and percentage depletion and intercorporate dividend received deduction.

During 1971, a number of extraordinary gains and losses were incurred with the net result that losses exceeded gains by \$988,000 or 12 cents per share. See Note E to the Summary of Operations for details.

#### 1972 vs. 1971

Sales and earnings from continuing operations in 1972 increased over those of 1971 due primarily to strong demand for copper products and productivity gains. Earnings before taxes from metal manufacturing operations were \$18,584,000, a 90% increase over the \$9,793,000 reported in 1971. Sales rose 10% to \$301,597,000 from \$273,455,000 in the prior year.

Real estate sales and earnings increased in 1972 to \$114,668,000 and \$5,609,000, respectively. On February 1, 1972 Cerro acquired 65% of Behring Corporation for \$13.6 million which together with a former wholly owned Cerro subsidiary, Leadership Housing Systems, Inc., was merged on September 1, 1972, into a newly formed company, Leadership Housing, Inc. (LHI). As a result of this merger, Cerro owned approximately 80% of LHI.

In October 1972, Cerro acquired Illinois-California Express, Inc. (ICX) a major motor freight carrier. For the last three months of 1972, sales and pre-tax earnings were \$11,756,000 and \$1,183,000, respectively.

In December 1972, operations of the Stereo Tape Club of America were discontinued. Stereo sustained an operating loss in 1972 of \$4,583,000. The extraordinary net loss from liquidation was \$3,076,000. The net operating losses for 1972 and 1971 are reported in the Summary of Operations as discontinued operations.

Dividends from Cerro's 22¼ percent interest in Southern Peru Copper Corporation were suspended in the second half of 1972 to free additional funds for expansion of the Cuajone copper mine. Earnings of S.P.C.C. continued at approximately the same rate as in 1971.

#### 1973 vs. 1972

Sales in 1973 were \$638,607,000, 49 percent higher than the \$428,021,000 reported in 1972.

Metal manufacturing, with sales of \$417,802,000 and pre tax earnings of \$34,111,000 was the largest contributor to the sales and earnings growth over 1972. These improvements reflect the significantly higher selling prices and volume that resulted from strong demand and shortages of fabricated metal products throughout the world.

Effective January 1, 1973, Cerro adopted the First-In, First-Out (FIFO) method of valuing metal inventories at one of its manufacturing plants which had previously reported on the Last-In, First-Out (LIFO) basis. For comparative purposes, the Summary of Operations have been restated to

reflect this change in accounting. The effect on net earnings per share for each of the years was as follows:

	<u>FIFO Basis</u>	<u>LIFO Basis</u>
1972 .....	\$2.10	\$2.09
1971 .....	.19	.33
1970 .....	1.65	2.19

Pre-tax earnings from trucking operations (ICX) improved 17% from the prior year with revenues up 19%.

Real estate earnings increased over 1972 by 111% to \$11,884,000 while sales increased 39%. There were 2,342 single family homes and condominiums delivered during the year and 2,152 rental apartment units. In addition, land sales of approximately \$30,000,000 were substantially greater than those of 1972.

In June 1973, Cerro sold its 50% interest in Atlantic Cement for \$38,500,000 resulting in a gain of \$2,116,000. Cerro's equity in net earnings reported as a Discontinued Operation in the accompanying Summary of Operations, through the date of the sale was \$1,556,000.

On January 1, 1974 the Government of Peru expropriated Cerro's wholly owned subsidiary, Cerro de Pasco Corporation (Cerro-Peru) which resulted in a financial statement loss in 1973 after compensation, but before tax benefit of \$110,350,000. The tax loss on the expropriation after adjusting the financial statement loss primarily for non-tax deductible pensions and severance reserves was approximately \$135,000,000. On February 19, 1974, based on an agreement between the Governments of Peru and the United States, Cerro received \$58,000,000, including repatriation of 1973's net earnings, from Peru. In December 1974 Cerro received an additional \$10,000,000 from the U.S. Government as part of a lump sum settlement agreed to by the U.S. and Peru. The net after-tax loss from expropriation reflected as an extraordinary item in the accompanying financial statements for 1973 is \$45,550,000 or \$5.50 a share.

#### 1974 vs. 1973

Pre-tax earnings from metal manufacturing operations increased 36 percent over 1973 to \$46,414,000 primarily due to stronger demand for most products, even though market conditions seriously slackened in the last quarter of 1974.

The real estate operations sustained a substantial loss in 1974 of \$13,606,000 on sales of \$96,006,000 which were down by \$64,000,000 from the prior year. The loss is attributable to depressed housing markets and increased building costs, as well as materially reduced land sales and the high cost of financing.

Trucking operations experienced a slight reduction, 10 percent, in pretax earnings from the prior year although revenues were up by 25 percent. Increased fuel and labor costs along with a reduction in shipments were not fully offset by increased rate adjustments granted during the year.

Mining operations experienced a substantial increase in earnings and sales as a result of the acquisition in September 1974 of the Fetterolf Coal Group. This segment of the operations had pretax earnings of \$10,230,000 on sales of \$21,446,000. However, with the settlement of the coal strike and lower steel production, it is not expected that the high level of earnings experienced in 1974 will be maintained.

### ITEM 3. PROPERTIES\*

#### MANUFACTURING GROUP

Cerro's fabricating and manufacturing operations in the United States are carried on at ten principal plant locations in seven states. Set forth below is the aggregate size and theoretical annual productive capacity of each of these plants together with the approximate percentage of capacity at which each plant operated during 1974.

<u>Location</u>	<u>Theoretical Capacity</u>	<u>Percent Capacity Operated</u>	<u>Floor Space sq. ft.</u>
<i>Division</i>			
<b>Cerrocu</b>			
Sauget, Ill. ....			750,000
cathode .....	42,000 tons	100 %	
tube .....	55,500 tons	76 %	
Cleveland, Ohio tube .....	4,500 tons	95 %	217,000
<b>Cerrowire</b>			
Maspeth, N. Y. ....	72,000,000 lbs.	78 %	626,000
Syosset, N. Y. ....			274,000
copper rod .....	200,000,000 lbs.	62 %	
electrical metallic tubing .....	80,000,000 ft.	99.6%	
New Haven, Conn. ....	9,000,000 lbs.	91 %	235,000
Mystic, Conn.** .....	8,000,000 lbs.	85 %	71,000
<b>Cerrocum</b>			
Freehold, N. J.*** .....	—	—	130,000
<b>Cerromet</b>			
Bellefonte, Pa. ....	168,000,000 lbs.	72 %	645,000
Newark, Cal. ....	40,000,000 lbs.	55 %	91,000
<b>Golconda</b>			
Chicago, Ill.*** .....	—	—	503,000

\* For a discussion of the Mining Group's properties, see text under the heading "Mining Group" at page 10.

\*\* During 1975, this property will be sold and its bare conductor manufacturing operations will be transferred to a newly acquired plant at East Granby, Connecticut; this plant will also be used for the expansion of the insulating operations of the New Haven plant. Estimated annual capacity of the new plant: bare conductors — 8,000,000 lbs.; insulated wire — 4,000,000 lbs.

\*\*\* Theoretical capacity and percentage thereof are not meaningful to an understanding of the business of these facilities due to the product mix produced and the constant changes therein.

Except for the Cleveland plant, of which 132,000 square feet are leased under leases expiring December 31, 1980, renewable to 1995, all such plants are owned in fee (equipment leased at the Freehold, New Jersey plant). Such leases contain options on Cerro's part to purchase the properties and equipment covered thereby.

Golconda has five manufacturing facilities (including the Chicago, Illinois plant described above) of which four are owned and one is leased, having a total area of approximately 809,000 square feet, all of which are located in Illinois with the exception of its food service equipment plant located in Michigan.

## REAL ESTATE GROUP

The major landholdings of Leadership, other than those presently under development with the joint ventures, consist of 531 acres in Broward County, Florida; 3,900 acres in Tarpon Lake, Florida; 530 acres in Orange County, California; and an aggregate of 136 acres on Maui and Kauai, Hawaii. In addition, at the end of 1973, and the beginning of 1974, Leadership held, or was negotiating to acquire, options covering substantial additional property in California and Hawaii. As the home-building industry deteriorated in 1974, Leadership ceased negotiations to acquire options on additional property and allowed other options to expire without exercise. The losses in 1974 attributable to the options which expired aggregated approximately \$1.2 million.

## TRUCKING GROUP

At December 31, 1974, the Trucking Group owned eighteen terminals. In addition, seventeen terminals were leased by the Trucking Group at an aggregate rental of approximately \$789,000 per annum. The leases on the terminals, one of which is on a month to month basis, expire at various dates through December 31, 1987.

The Trucking Group owns 270 road tractors, 462 converter gears and 1,663 road trailers. In addition, the Trucking Group owns 825 pieces of local equipment consisting of pickup tractors, pickup trailers, pickup trucks, service tractors and service trucks.

## ITEM 4. PARENTS AND SUBSIDIARIES

The Marmon Group, Inc. (Michigan) ("Marmon"), owns 3,586,297 shares of the Common Stock of Cerro, or approximately 45% of the outstanding shares. GL Corporation owns 100% of the outstanding stock of Marmon and members of the Pritzker family are the beneficial owners of all of the outstanding stock of GL Corporation. The Pritzker family, for this purpose, consists of the descendants, and their spouses, of Nicholas J. Pritzker, deceased, including Messrs. Jay A. and Robert A. Pritzker who are the Chairman of the Board and the President of Cerro, respectively.

Following is a list of certain subsidiaries of Cerro indicating the percentage of ownership by Cerro of the voting securities, and the jurisdiction of incorporation, of each:

<u>Name of Subsidiary*</u>	<u>Percentage of Voting Securities Owned</u>	<u>State or Other Jurisdiction of Incorporation</u>
Cerro Sales Corporation .....	100	Delaware
Cerro Spar Corporation .....	100	Kentucky
Fetterolf Coal And Construction, Inc. ....	100	Delaware
Golconda Corporation .....	85	Idaho
Illinois — California Express, Inc.** .....	94	Nebraska
Leadership Housing, Inc. ....	100	Delaware
M. F. Fetterolf Coal Co., Inc.† .....	100	Pennsylvania
M. F. Land Company, Inc.† .....	100	Pennsylvania

In addition, Cerro has a number of other subsidiaries, which considered in the aggregate as a single subsidiary, would not constitute a significant subsidiary.

\* Indicates subsidiaries included in consolidated financial statements.

\*\* ICX is a third-tier subsidiary of Cerro. The intervening subsidiary corporations are Cerro Motor Express Corporation (100% owned by Cerro) and ICX Industries, Inc. (94% owned by Cerro Motor Express Corporation).

† Wholly owned subsidiaries of Fetterolf Coal And Construction, Inc.

### ITEM 5. PENDING LEGAL PROCEEDINGS

As of March 27, 1975, there were no pending legal proceedings to which Cerro or any of its subsidiaries is a party, or to which any of their property is subject, the results of which are likely to be materially adverse to Cerro. In addition, there are no suits or proceedings pending or, to the knowledge of Cerro, threatened, under any civil rights or environmental protection statutes, which, in the aggregate, could have a materially adverse effect on Cerro.

### ITEM 6. INCREASES AND DECREASES IN OUTSTANDING SECURITIES

The following information relates to the increases and (decreases) in the amount of equity securities of Cerro outstanding during the last fiscal year:

(1) *Cerro Common Stock*

Outstanding, December 31, 1973 .....	7,947,867
Open market purchases .....	(36,600)
Outstanding, December 31, 1974 .....	<u>7,911,267</u>

(2) *Options to Acquire Common Stock*

See Note 10 of Notes to Financial Statements of Cerro Corporation and Consolidated Subsidiaries.

(b) The following information relates to all securities of Cerro sold by Cerro during the fiscal year which were not registered under the Securities Act of 1933, in reliance upon an exemption from registration provided by Section 4(2) of that Act:

(1) *Cerro Corporation Promissory Note to Golconda Corporation*

Reference is made to the Cerro Form 8-K for the month of April 1974.

(2) *Guaranty*

On December 12, 1974 Cerro issued a guarantee to the European Coal and Steel Community ("ECSC") guaranteeing the indebtedness of Tubes Euro-Lens S.A. ("TEL") a French corporation and a 49.5% owned affiliate of Cerro, in an amount of up to 50% of the indebtedness of TEL incurred pursuant to a Loan Agreement of December 12, 1974 among TEL and ECSC under the terms of which TEL has borrowed 42 million Lux. Francs (approximately \$1,229,340 at March 18, 1975 exchange rates). The loan bears interest at a rate of 6.25% per annum for the period ending 5 years after the date of borrowing of the funds and 9.25% for the remaining period. The loan is repayable in 10 annual installments of 4,200,000 Lux. Francs each, payable on January 15 of each year commencing 1979 and ending 1988.

In addition, some liability under French law may attach to Cerro for up to 50% of an outstanding six-year loan of approximately \$1.0 million to TEL in the event of default by reason of the execution and delivery by Cerro of a certain letter of intent to the lending institution.

### ITEM 7. APPROXIMATE NUMBER OF EQUITY SECURITY HOLDERS; MARKET PRICES AND DIVIDENDS

As of December 31, 1974, as reported by Irving Trust Company, Transfer Agent.

<u>Title of Class</u>	<u>Number of Holders of Record</u>
Cerro Corporation Common Stock .....	19,993

The principal trading market for Cerro's common stock is the New York Stock Exchange. The following table sets forth for the periods indicated the reported high and low selling prices of Cerro common stock on the New York Stock Exchange, and the dividends paid per share of common stock:

	High	Low	Dividend
1973			
First Quarter .....	\$16 $\frac{7}{8}$	\$14 $\frac{1}{2}$	\$.10
Second Quarter .....	16 $\frac{1}{2}$	13 $\frac{1}{2}$	.20
Third Quarter .....	15 $\frac{1}{2}$	12 $\frac{1}{2}$	.20
Fourth Quarter .....	17 $\frac{1}{2}$	13	.25
1974			
First Quarter .....	\$19 $\frac{1}{2}$	\$13 $\frac{1}{2}$	\$.25
Second Quarter .....	19 $\frac{1}{2}$	14	.25
Third Quarter .....	19 $\frac{1}{2}$	11 $\frac{1}{2}$	.25
Fourth Quarter .....	13 $\frac{1}{2}$	11 $\frac{1}{2}$	.30

#### ITEM 8. EXECUTIVE OFFICERS OF CERRO; DIRECTORS

(a) Listed below, as of March 27, 1975, are the names and ages of all executive officers of Cerro Corporation and the positions and offices of Cerro Corporation held by each:

Jay A. Pritzker .....	Chairman of the Board	52
Robert A. Pritzker .....	President	48
Alan Wolfiev .....	Executive Vice President	51
H. Willis Higgs .....	Vice President	57
Peter D. Weisse .....	Vice President	45
Michael D. David .....	Vice President	59
Paul J. Bennett .....	Vice President and Controller	38
S. Roy French, Jr.* .....	Vice President and General Counsel	45
J. Hugh Murphy* .....	Secretary and Assistant General Counsel	43
Robert F. Long* .....	Treasurer	33

\* Messrs. S. R. French, Jr. and J. H. Murphy resigned their positions with Cerro, effective April 30, 1975. R. F. Long resigned as Treasurer of Cerro effective upon the completion of certain specified duties. Mr. Kenneth D. Archer, 35 years of age, has been designated to succeed Messrs. French and Murphy, subject to the approval of Cerro's Board of Directors. Mr. Archer has been Assistant Counsel of Cerro since November 1973. From December 1970 until November 1973 he was Associate Counsel of GAF Corporation, a diversified manufacturer of chemicals, photographic products and building materials. Prior thereto he was associated with the New York law firm of Shearman & Sterling. As of March 27, 1975, the successor to Mr. Long has not been chosen.

Messrs. Jay A. Pritzker and Robert A. Pritzker are brothers. There are no other family relationships among the executive officers of Cerro.

(b) Business experience of each executive officer during past five years:

##### JAY A. PRITZKER

Mr. Pritzker became a director of Cerro in March 1974 and Chairman of the Board of Cerro in February 1975. He is presently Chairman of the Board of Marmon (since 1963); Chairman of the Board of GL Corporation (since 1971); Chairman of the Board of Hyatt Corporation (since 1967) as well as an attorney and member of the law firm of Pritzker and Pritzker.

**ROBERT A. PRITZKER**

Mr. Pritzker became a director of Cerro in December 1974 and its President in February 1975. He is the President and a director of Marmon, which positions have been held for more than five years and Treasurer of Marmon (since 1972); President, Treasurer and Director of GL Corporation (since 1971); Chairman of the Board of Hammond Corporation (manufacturer of musical instruments and gloves) since 1974.

**ALAN WOLFLEY**

Mr. Wolfley joined Cerro in May 1971 as Vice President-Finance and Treasurer. He became Vice President-Finance and Administration in September 1971; Senior Vice President-Finance and Administration in May 1972; and Executive Vice President in May 1973. Prior to joining Cerro, Mr. Wolfley was Vice President-Finance of Scovill Manufacturing Company (brass and aluminum mill products, electrical and kitchen appliances).

**H. WILLIS HIGGS**

Mr. Higgs has been a Vice President in charge of Cerro's mining operations for more than five years.

**PETER D. WEISSE**

Mr. Weisse has been Vice President of the Cerro manufacturing group since March 1971. From April 1968 until joining Cerro, he was President of AMAX Aluminum Metal Products, Inc. (aluminum fabricating), subsidiary of Amax, Inc.

**MICHAEL D. DAVID**

Mr. David has been a Vice President of Cerro for more than five years.

**PAUL J. BENNETT**

Mr. Bennett has been Controller of Cerro since August 1971, and Vice President since May 1972. From May 1970 to July 1971, Mr. Bennett was Controller of Fairchild Camera & Instrument Corporation (electrical components and systems), and prior thereto Group Controller, Molybdenum and Specialty Metals Group of Amax, Inc. (metals and chemicals).

**S. ROY FRENCH, JR.**

Mr. French has been a Vice President since May 1973 and the senior legal officer of the Company since July 1971 (General Counsel since October 1972). Since 1968 Mr. French has served Cerro as Assistant Secretary, Assistant General Attorney, and Secretary of the Company.

**J. HUGH MURPHY**

Mr. Murphy joined Cerro as Assistant General Attorney in October 1971. He became Assistant Secretary in July 1972; Assistant General Counsel in October 1972; and Secretary in September 1973. Prior to joining Cerro, Mr. Murphy was a partner of the New York City law firm of Rogers, Hoge & Hills, a firm with which he was associated for 8 years.

**ROBERT F. LONG**

Mr. Long joined Cerro as Manager of Taxes in March 1972. He became Assistant Controller in May 1973 and Treasurer in May 1974. Prior to joining Cerro, Mr. Long was Tax Manager with the firm of Arthur Andersen & Company in New York City with which he was employed since June 1963.



(c) Directors of Cerro

Messrs. Jay A. Pritzker, Robert A. Pritzker, and Alan Wolfley are Directors of Cerro. The other directors of Cerro and their respective principal occupations are as follows:

<u>Names</u>	<u>Occupation</u>
Robert H. Cutler .....	Chairman, Illinois-California Express, Inc.
Thomas F. Githens .....	Senior Vice President and Director, Smith, Barney & Co., Inc.
Louis B. Harder .....	Chairman (Chief Executive Officer) International Mining Corporation
Charles B. Harding .....	Member, Advisory Board, Smith, Barney & Co., Inc.
William L. Henry .....	Executive Vice President, Gulf Oil Corporation
Adrian M. Massie .....	Consultant and member Trust Committee, Chemical Bank
G. Willing Pepper .....	Chairman, The Institute for Cancer Research
John B. Stone .....	Geological and Mining Consultant

Messrs. Harding, Henry, Massie, and Stone are not standing for re-election as Directors at the annual meeting of Cerro to be held May 13, 1975. George A. Jones, Executive Vice President of Marmon, and Robert C. Gluth, Vice President of Marmon, have been added to the slate of Directors for election at Cerro's annual meeting.

**Item 9. Indemnification of Directors and Officers**

The New York Business Corporation Law and the General Corporation Law of the State of Delaware provide authority for the indemnification of directors and officers in the defense of civil and criminal actions and the purchase of insurance in connection therewith. The By-Laws of Cerro and Leadership Housing, Inc. permit indemnification of directors and officers to the full extent and in the manner permitted by the laws of the States of New York and Delaware, respectively. Accordingly, Cerro and Leadership have purchased from Continental Casualty Company and the Midland Insurance Company insurance covering the liability of directors and officers. The insurance applies to the directors and principal officers of Cerro and Leadership. The premiums paid for this insurance aggregate \$158,822 covering the period from September 26, 1973 to September 26, 1976.

**Item 10. Financial Statements and Exhibits Filed**

**(a) Financial Statements**

Cerro Corporation and Consolidated Subsidiaries; Cerro Corporation (Registrant)

**(b) Exhibits**

1. — Amendments of August 14 and December 11, 1974 and February 12, 1975 to By-laws of Cerro.
2. — Letter of January 8, 1975 from Aetna Life Insurance Company to Cerro amending Note Agreement of February 6, 1967.
3. — Letter of December 31, 1974 from The Prudential Insurance Company of America to Cerro amending the Note Agreement of February 6, 1967.
4. — Letter of December 26, 1974 from The Prudential Insurance Company of America to Cerro amending the Note Agreement of February 6, 1967.
5. — Letter of November 15, 1974 from Aetna Life Insurance Company to Cerro amending the Note Agreement of February 6, 1967.

6. — Letter of September 5, 1974 from The Prudential Insurance Company of America to Cerro amending the Note Agreement of February 6, 1967.
7. — Letter of July 1, 1974 from Aetna Life Insurance Company to Cerro amending the Note Agreement of February 6, 1967.
8. — Letter of May 9, 1974 from The Prudential Insurance Company of America to Cerro amending the Note Agreement of February 6, 1967.
9. — Letter of February 12, 1974 from The Prudential Insurance Company of America to Cerro consenting to the payment of a cash dividend.
10. — Consent by Aetna Life Insurance Company to the payment of a cash dividend by Cerro dated February 6, 1974.
11. — 1974 Incentive Compensation Plan for Cerro Corporation (Headquarters).
12. — 1974 Incentive Compensation Plan for Cerroman (Manufacturing Group Headquarters).
13. — 1974 Incentive Compensation Plan for Cerro Wire & Cable Co. Division.
14. — 1974 Incentive Compensation Plan for Cerro Wire & Cable Co. Division — Maspeth/Syosset.
15. — 1974 Incentive Compensation Plan for Cerro Wire & Cable Co. Division — New Haven/Mystic.
16. — 1974 Incentive Compensation Plan for Cerro Communications Products Division.
17. — 1974 Incentive Compensation Plan for Cerro Copper Products Division.
18. — 1974 Incentive Compensation Plan for Cerro Metal Products Division.
19. — 1974 Incentive Compensation Plan for Cerro Sales Corporation.
20. — 1974 Incentive Compensation Plan for Peruvian Industrial Affiliates.
21. — 1974 Incentive Compensation Plan for Cerromin (Mining Group Headquarters).
22. — 1974 Incentive Compensation Plan for Cerro Purchasing, Inc.
23. — 1974 Incentive Compensation Plan for Cerro Spar, Inc.
24. — 1974 Incentive Compensation Plan for M. F. Land Company, Inc. a wholly owned subsidiary of Fetterolf Coal and Construction, Inc., a wholly owned subsidiary of Cerro Corporation.
25. — 1974 Incentive Compensation Plan for ICX Industries, Inc.
26. — 1974 Incentive Compensation Plan for Leadership Housing, Inc.
27. — Agreement between Cerro and C. Gordon Murphy dated June 12, 1974.
28. — Amendment dated December 16, 1974 to Exhibit 27.
29. — Agreement between Cerro and C. Gordon Murphy and letters relating thereto dated February 12, 1975.
30. — Agreement of February 12, 1975 between Cerro and S. Roy French, Jr.
31. — Agreement of February 12, 1975 between Cerro and H. Willis Higgs.
32. — Agreement of February 12, 1975 between Cerro and J. Hugh Murphy.
33. — Agreement of February 12, 1975 between Cerro and Robert F. Long.
34. — Amendment dated February 12, 1975 to Agreement of May 30, 1972 between Leadership Housing, Inc. and Harrison M. Lasky.
35. — Promissory Note of Cerro to Golconda Corporation dated April 4, 1974.
36. — Guaranty of Cerro dated December 12, 1974 to the European Coal and Steel Community.

37. — Coal Sales Agreement dated October 1, 1975 by and among Fetterolf Coal And Construction, Inc. and Sumitomo Metal Industries, Ltd. and Mitsubishi Corporation and addendum thereto.
38. — Loan Agreement of October 1, 1974 by and among Fetterolf Coal And Construction, Inc. and Mitsubishi Corporation and Sumitomo Metal Industries, Ltd.
39. — Amendment as of December 16, 1974 to Exhibit No. 38.
40. — Letter of October 1, 1974 from Cerro to Mitsubishi Corporation and Sumitomo Metal Industries, Ltd. relating to Exhibits No. 37 and No. 38.
41. — Operating Agreement of March 11, 1975 by and among Fetterolf Coal And Construction, Inc. and Mitsubishi Corporation and Sumitomo Metal Industries, Ltd.
42. — Loan Agreement of Leadership Housing, Inc. dated October 4, 1973 and amendments thereto.
43. — General Indemnity Agreement of May 1971 between Cerro and Argonaut Insurance Company.
44. — General Indemnity Agreement between Cerro and Highland Insurance Company.
45. — Amendment of March 14, 1975 of the joint venture agreement of Leadership Housing, Inc. dated December 20, 1972.

A copy of any exhibit may be obtained by a stockholder of Cerro by making a written request therefor to the Secretary of Cerro and by paying Cerro's costs of reproduction and postage.

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## PART II

Items 11 through 15, which relate to information to be included in Cerro's proxy statement, have been omitted from this report pursuant to General Instruction H to Form 10-K.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CERRO CORPORATION  
(Registrant)

By .....  
J. Hugh Murphy, Secretary

Date: March 31, 1975

## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and  
Shareholders of Cerro Corporation

We have examined the financial statements, listed in the accompanying index, of Cerro Corporation and Consolidated Subsidiaries and of Cerro Corporation (registrant). Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 12, the Company's real estate subsidiary, Leadership Housing, Inc. ("Leadership"), requires additional funds for working capital purposes. Negotiations are in progress to arrange the necessary financing but a definitive arrangement has not yet been reached. In the event that suitable financing arrangements are not made, it is anticipated by the Company that Leadership will not be able to continue as an ongoing business.

In our opinion, subject to the effects, if any, on the financial statements of the ultimate resolution of the matter referred to in the preceding paragraph, the financial statements listed in the accompanying index present fairly the financial position of Cerro Corporation and Consolidated Subsidiaries and of Cerro Corporation (registrant) at December 31, 1974 and 1973, the results of their operations and the changes in financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied.

PRICE WATERHOUSE & CO.

New York, New York  
February 25, 1975 (except for  
Note 12 as to which the date  
is March 27, 1975)

F-1

LS 001193

# CERRO CORPORATION (REGISTRANT)

## CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

### INDEX TO FINANCIAL STATEMENTS AND SCHEDULES

For the Years Ended December 31, 1974 and 1973

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Financial statements:	
Cerro Corporation and Consolidated Subsidiaries:	
Consolidated statements of earnings, retained earnings and paid-in capital and related notes .....	19 — 25
Consolidated balance sheet at December 31, 1974 and 1973 .....	F-3
Consolidated statement of changes in financial position .....	F-4 — F-5
Notes to financial statements .....	F-6 — F-19
Cerro Corporation (Registrant):	
Statements of earnings, retained earnings, and paid-in capital .....	F-20 — F-21
Balance sheet at December 31, 1974 and 1973 .....	F-22
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Schedules:	
Cerro Corporation and Consolidated Subsidiaries:	
Schedule II — Accounts receivable from directors, officers and employees .....	F-27
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Cerro Corporation (Registrant):	
<del>Schedule</del> II — Accounts receivable from directors, officers and employees .....	F-27
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Schedule V — Property, plant and equipment .....	F-38
Schedule VI — Allowances for depreciation and amortization of property, plant and equipment .....	F-39
Schedule XII — Valuation and qualifying accounts and reserves .....	F-40

Schedules other than those listed above have been omitted since either, they are not required, or they are not applicable, or the required information is disclosed in the notes to the financial statements.

Financial statements are not filed for certain of the unconsolidated subsidiaries of the registrant since such subsidiaries, in the aggregate, would not constitute a significant subsidiary.

# CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

## CONSOLIDATED BALANCE SHEET

December 31, 1974 and 1973

(\$ in Thousands)

ASSETS	1974	1973
Current Assets:		
Cash	\$ 22,181	\$ 12,073
Time and certificates of deposit (includes \$104,000 of restricted deposits in 1974 — Note 3)	117,382	59,613
Marketable securities at cost, less reserve of \$2,069 in 1974 — approximately market	41,843	20,767
Receivable from Peru Government (Note D)	—	30,415
Accounts, notes and other receivables, less allowances for doubtful accounts of \$1,098 in 1974 and \$1,363 in 1973 (Schedules II and XII)		
Trade	53,987	57,652
Chile (Note 5)	4,859	—
Other	4,588	2,984
Inventories (Note 4)	90,769	67,674
Prepaid expenses	2,248	1,539
Total current assets	337,857	252,717
Realty assets (Notes 12 and 13)	212,127	204,822
Receivable from U.S. Government (Note D)	—	10,000
Notes due from Chile (Note 5)	25,251	35,674
Future income tax benefit (Notes C and D)	38,297	64,800
Investments (Note 8) (Schedule XII)	16,297	20,159
Property, plant and equipment, net (Note 7) (Schedules V and VI)	119,612	56,812
Operating rights and intangibles, net of amortization	15,148	14,784
	<u>\$764,589</u>	<u>\$659,568</u>

## LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities:		
Long-term debt due within one year (Note 9)	\$ 14,679	\$ 5,092
Accounts payable (Note 3)	101,095	51,542
Accrued liabilities (Note 8)	38,542	23,514
Total current liabilities	154,316	80,148
Realty liabilities (Notes 12 and 13)	152,624	146,950
Long-term debt (Note 9)	98,801	74,491
Deferred income taxes (Note C)	—	10,273
Deferred income	1,196	1,483
Minority interest (Note 2) (Schedule XIII)	6,553	175
Total liabilities	411,490	313,520
Shareholders' Equity (Notes 9, 10, and 11)		
Common stock, par value \$3.33 1/4 per share, authorized 15,000,000 shares issued 8,779,654 shares	29,265	29,265
Paid-in capital	178,218	178,218
Retained earnings (Note 9)	161,935	154,323
Treasury shares, at cost, 868,387 and 831,787	369,418 (16,319)	381,806 (15,758)
Total shareholders' equity	353,099	346,048
	<u>\$764,589</u>	<u>\$659,568</u>

See Notes to Financial Statements (numerical references)  
and Notes to Summary of Operations (alphabetical references).

**CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION**

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

SOURCES OF FUNDS

	<u>1974</u>	<u>1973</u>
Earnings from continuing operations .....	\$ 15,927	\$ 15,378
Continuing operations not (providing) or requiring funds:		
Income taxes — not payable due to expropriation loss (Cerro de Pasco) .....	28,503	—
Deferred income taxes, net .....	(10,273)	385
Realty (earnings) losses not included in consolidated funds .....	13,606	(11,884)
Investment reserves .....	290	8,205
Depreciation and amortization .....	8,444	6,535
Minority interest, equity and dividends, net .....	711	330
Total funds from continuing operations .....	<u>55,208</u>	<u>18,949</u>
Earnings from discontinued operations (less equity in income of Atlantic Cement of \$1,556 which did not provide funds) .....	—	32,227
Extraordinary expropriation loss .....	—	(45,550)
Less book value of investment in Cerro de Pasco, net of tax, which did not require funds .....	—	64,897
	<u>—</u>	<u>19,347</u>
Funds from other sources:		
Payment from U.S. Government .....	10,000	—
Reduction in notes due from Chile (includes \$4,859 classified as current) .....	10,423	—
Book value portion of proceeds on sale of Atlantic Cement .....	—	36,374
Long-term borrowing .....	40,892	23,262
Sale of property, plant and equipment .....	1,105	1,157
Total funds from other sources .....	<u>62,220</u>	<u>60,793</u>
Total sources of funds .....	<u>\$117,428</u>	<u>\$131,316</u>

**CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION — (Continued)**

**For the Years Ended December 31, 1974 and 1973**

(\$ in Thousands)

**USES OF FUNDS**

	<u>1974</u>	<u>1973</u>
Acquisitions of companies (excluding net current assets):		
Property, plant and equipment .....	\$ 48,668	\$ —
Long-term debt assumed .....	(19,418)	—
Minority interest and other .....	(3,992)	—
	<u>25,258</u>	<u>—</u>
Investment in real estate operations, net .....	15,437	4,864
Purchase of property, plant and equipment .....	17,455	9,077
Purchase of treasury stock .....	561	8,296
Cash dividends .....	8,315	6,186
Reduction of long-term debt .....	37,800	18,240
Other, net .....	1,630	1,421
Total funds used .....	<u>106,456</u>	<u>48,084</u>
Increase in working capital .....	<u>\$ 10,972</u>	<u>\$83,232</u>

**INCREASE IN WORKING CAPITAL**

Cash, deposits and marketable securities .....	\$ 88,953	\$50,120
Receivable from Peru Government .....	(30,415)	30,415
Accounts, notes and other receivables, net .....	2,798	3,015
Inventories .....	23,095	10,548
Deferred income taxes .....	—	(10,990)
Prepaid expenses .....	709	29
	<u>85,140</u>	<u>83,137</u>
Long-term debt due within one year .....	(9,587)	12,754
Accounts payable .....	(49,553)	(17,507)
Accrued liabilities .....	(15,028)	4,848
	<u>(74,168)</u>	<u>95</u>
Increase in working capital .....	<u>\$ 10,972</u>	<u>\$83,232</u>

See Notes to Financial Statements (numerical references)  
and Notes to Summary of Operations (alphabetical references).



# CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

## NOTES TO FINANCIAL STATEMENTS

### 1. Summary of Accounting Principles

Accounting principles followed by Cerro and its operating units are generally consistent with their respective industry practices. Significant accounting policies are as follows:

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of all domestic subsidiaries. The investment in Southern Peru Copper Corporation ("Southern Peru"), a 22¼% owned affiliate is carried at cost, as are all other investments. Operating results of foreign subsidiaries are translated to U. S. dollars at average exchange rates in effect during the year, except for depreciation and depletion which are based on historical cost.

#### *Inventories*

Inventories are recorded at the lower of cost or market with cost computed primarily on a First-In, First-Out (FIFO) basis.

#### *Property, Plant and Equipment*

Property, plant and equipment are recorded at cost. Gain or loss on retirement is included in earnings. Maintenance and repairs are expensed; renewals and betterments are capitalized. Depreciation of plant and equipment is based on the estimated service lives of the assets using primarily the straight-line method for book purposes.

#### *Income Taxes*

Deferred taxes are provided to account for the difference for accounting and tax purposes in the recognition of certain income and expense items. Principally these consist of the excess of accelerated tax depreciation over book depreciation, the use of the installment sales method for tax purposes with respect to certain real estate transactions which are recorded on the accrual basis for financial reporting, the current tax deduction of real estate taxes and interest capitalized for financial reporting purposes, and expenses and income recognized in different years for tax purposes than for accounting purposes.

The investment tax credit is accounted for as a reduction of the current provision for U. S. income taxes.

#### *Intangibles*

Operating rights, franchises and permits obtained through the purchases of ICX Industries, Inc. and the excess of cost of investments over the fair value of assets acquired in purchase transactions are being amortized on a straight-line basis over a period of forty years. Operating rights acquired prior to October 31, 1970 (\$3,400,000) are not being amortized since, in the opinion of management, there has been no diminution in their value.

#### *Exploration, Research and Product Development*

Exploration expenses incurred in the search for new mining properties and research and development expenses for new or existing products are charged to earnings as incurred. Development costs to bring new mineral properties into production are capitalized and amortized over the anticipated life of the ore reserve when production begins.

### **Pensions**

Cerro has several pension plans covering most of its employees. Pension costs are actuarially determined and are funded as accrued, which include, as to certain of the plans, amortization of prior service costs over periods not exceeding 30 years. Estimated vested benefits for certain plans as of December 31, 1974 exceeded the respective pension funds' assets and related balance sheet accruals by approximately \$8,000,000. Estimated unfunded past service costs totaled approximately \$20,000,000 at the end of 1974.

Cerro does not have information available for its various retirement plans to estimate the impact of the Pension Reform Act of 1974 on net income for 1976, when the new law becomes fully effective, or the possibilities of increased funding requirements, administration expenses and unfunded vested benefits. Management believes that additional pension expense and funding requirements expected to result from any required amendments to the company's plans should not be material in relation to present expense for these plans. The unfunded vested benefits are expected to increase, but the amount of such increase will not be determinable until management decides how its present vesting provisions will be amended to conform with the new law.

### **Real Estate**

See Notes 12 and 13

### **2. Business Combinations**

See Note F to the Summary of Operations contained elsewhere herein.

### **3. Restricted Deposits**

In December 1974, Cerro entered into copper sales agreements under which it received approximately \$65,000,000 in advance. \$50,000,000 of that amount has been deposited in time deposits. In addition, Cerro has deposited approximately \$54,000,000 in nonnegotiable certificates of deposit with a financial institution. The \$104,000,000 of deposits which mature in March 1975 are shown in Cerro's balance sheet as restricted. Cerro's accounts payable at December 31, 1974 include obligations to customers amounting to approximately \$65,000,000 for delivery of the copper in March 1975.

### **4. Inventories**

Inventories (excluding real estate inventories) entering into the determination of net earnings were as follows:

	December 31,		
	1974	1973	1972
	(\$ in Thousands)		
Refined metals and ores .....	\$ 7,838	\$ 8,798	\$ 7,258
Manufacturing finished goods, work in process and raw materials	80,221	57,039	48,260
Operating supplies .....	2,712	1,837	1,608
	<u>\$90,769</u>	<u>\$67,674</u>	<u>\$57,126</u>

### **5. Notes due from Chile**

In 1971, the former Government of Chile expropriated Andina, a Chilean corporation 70% owned by Cerro. Andina is the owner and operator of the Rio Blanco copper mine in which Cerro had invested \$35,874,000 in the form of equity, notes and accrued interest.

On March 12, 1974, Cerro Corporation signed a compensation agreement with the Government of Chile for \$41,300,000 consisting of \$2,700,000 of cash and \$38,600,000 in seventeen year, 9.165% Series A and B Notes, which are exempt from Chilean taxes and guaranteed by the Central Bank of Chile. The notes and related interest are payable semi-annually. An amount of \$500,000 was also received representing payment for commissions earned on shipments made by a Cerro subsidiary on behalf of Andina. The difference (reserve) of \$5,600,000 between the principal settlement of \$41,300,000 and Cerro's book value at December 31, 1973 of approximately \$35,700,000 (reclassified from investments to receivables for comparability with 1974) represents principally interest earned since the date of expropriation on loans made by Cerro to Andina in 1966 and 1968. This interest had not been reflected in prior years earnings of Cerro as there was no reasonable assurance at that time of collection.

In addition, an agreement was entered into on July 14, 1974 between Cerro and the Overseas Private Investment Corporation (OPIC), an agency of the U.S. government whereby OPIC guarantees the payment in the event of default by the Chilean government, of a portion of the total face amounts of each of the Series B Notes. The amount guaranteed under this provision of the agreement at December 31, 1974 was approximately \$11,000,000.

Cerro and the Government of Chile have an arrangement covering the purchase and resale of certain copper-bearing materials produced in Chile which cannot be processed there and which are outside normal Chilean production and exports. The proceeds from the resale of these materials are to be applied to prepayment of the notes, in inverse order of maturity. It is expected that the proceeds from the resale of these materials will result in the prepayment of a substantial portion of the notes prior to their scheduled maturity. During 1974, Cerro received approximately \$3,000,000 in prepayments and \$2,700,000 in September 1974 in accordance with the normal payment terms of the agreement.

#### 6. Investments

Cerro's investments, at cost, are summarized below.

	Equity %	1974 (\$ in Thousands)	1973 (\$ in Thousands)
Southern Peru Copper Corporation .....	22 1/4	\$13,375	\$13,375
Northwest Iron Co., Ltd. ....	24	1,950	1,950
Cerro Spar Corporation .....	100	—	5,006
Peruvian affiliates .....	—	5,709	6,402
Mining and manufacturing ventures (principally foreign) .....	—	5,408	3,281
Reserve for investments .....	—	(10,145)	(9,855)
		<u>\$16,297</u>	<u>\$20,159</u>

#### *Southern Peru Copper Corporation*

Cerro's 22 1/4% equity interest in Southern Peru's book value was \$69,129,000 and \$60,122,000 as of December 31, 1974 and 1973 which exceeds its investment by \$55,754,000 and \$46,747,000 for 1974 and 1973, respectively. Despite the fact that Cerro owns 22 1/4% of Southern Peru, the company's proportionate share of Southern Peru's earnings is reported only as dividends are received. If the equity method had been used, Cerro's earnings from continuing operations would have increased by \$1.05 a share in 1974 compared with \$1.53 a share in 1973.

Southern Peru's net income for 1974 was \$40,480,000 compared to \$61,323,000 for 1973. However, no dividends were paid to shareholders. In the last half of 1972, dividends were suspended as Southern Peru used its earnings to aid in financing the development of the Cuajone Mine.

Pursuant to Peruvian law, mining communities, made up of Southern Peru's employees, may eventually receive 50% of the ownership in Southern Peru. As the equity interest of the mining communities increases, Cerro's share of the profits will decline proportionately.

*Northwest Iron Co., Ltd.*

Cerro's interest in a Tasmanian iron ore joint venture is held through its 24% ownership of Northwest. Cerro and the other owners of Northwest have agreed to advance sufficient funds to maintain working capital at specified amounts until certain outstanding indebtedness is repaid in 1983. Cerro was not required to advance funds to Northwest for this purpose in 1974 or 1973. Cerro is also contingently liable as a guarantor of certain debt of Northwest approximating \$7,300,000. Cerro has never received dividends from this affiliate.

Cerro's 24% share of the most recent profits of Northwest is:

Nine months ended December 31, 1974 (unaudited) .....	\$460,000
Fiscal year ended March 31, 1974 .....	471,000
Fiscal year ended March 31, 1973 .....	506,000

*Cerro Spar*

Cerro Spar is the owner of a 70% equity interest in a joint venture to mine fluorspar in Kentucky. The project became operational in 1974 and Cerro Spar's 1974 financial statements have been fully consolidated in the accompanying financial statements.

**7. Property, Plant and Equipment**

Non-realty property, plant and equipment are summarized below:

	<u>1974</u>	<u>1973</u>
	(\$ in Thousands)	
Land and buildings .....	\$ 40,841	\$ 30,817
Machinery and equipment .....	84,474	66,714
Mining properties .....	31,968	—
Revenue equipment .....	21,194	14,855
Construction in progress .....	3,728	722
	<u>182,203</u>	<u>113,108</u>
Less: accumulated depreciation .....	62,591	56,296
	<u>\$119,612</u>	<u>\$ 56,812</u>

**8. Accrued Liabilities**

Consist of the following:

	<u>1974</u>	<u>1973</u>
	(\$ in Thousands)	
Payroll .....	\$ 7,729	\$ 5,586
Income taxes .....	14,515	7,369
Interest .....	1,597	1,926
Pensions .....	4,848	2,488
Other .....	9,853	6,145
	<u>\$ 38,542</u>	<u>\$ 23,514</u>

## 9. Long-Term Debt

The following table gives the detail on Cerro's long-term debt:

	<u>Interest Rate</u>	<u>Due</u>	<u>1974</u>	<u>1973</u>
			(\$ in Thousands)	
Promissory notes to institutions(a) .....	6 3/4 %	1975-1987	\$ 26,000	\$28,000
Promissory notes to an institution(b) .....	6%	1975-1981	10,500	12,000
Promissory notes to corporations(c) .....	9.5%	1977-1987	35,000	—
Promissory notes to banks(d) .....	110% of Prime	1977	8,000	—
Promissory notes to European banks(e) .....	8%	1978	—	20,000
1st Mortgage note payable(f) .....	10%	1990	2,712	—
Subordinated debentures(g) .....	10%	1990	3,570	—
Subordinated promissory note to an individual(h) .....	12%	1975-1984	11,468	12,071
Other(i) .....	5-15%	1975-1990	14,230	7,512
			<u>111,480</u>	<u>79,583</u>
Less:				
Current portion .....			14,679	3,092
			<u>\$ 96,801</u>	<u>\$74,491</u>
Due to:				
Bank .....			\$ 9,262	\$23,320
Other .....			87,539	51,171
			<u>\$ 96,801</u>	<u>\$74,491</u>

(a) Payable in annual installments of \$2,000,000.

(b) Payable in annual installments of \$1,500,000.

(c) Payable in annual installments of \$3,500,000 and secured by mining properties.

(d) Prepaid on January 24, 1975. Accordingly the \$8,000,000 has been reflected as a current payable at December 31, 1974.

(e) Prepaid on April 30, 1974. In connection with the prepayment, Cerro also cancelled a revolving credit agreement for \$30,000,000. Cerro had not used any of the funds available under the revolving credit agreement.

(f) Secured by buildings and payable in monthly installments of \$28,975 including interest.

(g) Redeemable at Company's option at prices ranging from 104.5% in 1975 to 100% in 1984; annual sinking fund payments of \$325,000 are required beginning in 1977 with the option to make additional annual payments of \$325,000 beginning in 1975; debentures are convertible into common stock of Cerro's subsidiary (Golconda Corporation) at a conversion price of \$10.67 per share (subject to antidilution provisions).

(h) Payable in annual installments of \$1,207,000.

(i) Includes payables by ICX at December 31, 1974 and 1973 of \$10,288,000 and \$3,373,000, respectively, of which \$7,092,000 and \$1,400,000 was secured by revenue equipment.

Cerro has available unused bank lines of credit totaling \$59,000,000 at December 31, 1974. Under the terms of these arrangements, Cerro is to maintain compensating balances of 10% of the commitment plus 10% of any borrowings. Cerro also maintained in 1974 a compensating balance of approximately \$6,500,000 in connection with financing arrangements of its real estate operations, see Note 6 to Note 13.

The various note agreements impose certain restrictions on Cerro including the payment of cash dividends and reacquisition of capital stock. Approximately \$28,700,000 of retained earnings at December 31, 1974 was not restricted.

Payments of long-term debt during the next five years are as follows:

1976	\$5,871,000
1977	\$8,035,000
1978	\$7,198,000
1979	\$7,097,000
1980	\$7,121,000

#### 10. Stock Options

At December 31, 1974 Cerro had two stock option plans in effect covering officers and key employees. The 1970 Plan is qualified and discontinued as to additional grants whereas the 1971 Plan (Alternate Stock Option Plan) is nonqualified. The 1964 Plan expired on November 21, 1974. The terms of options under the two current plans generally are five years from the date of grant.

Optionees are not entitled to exercise both the stock options under the 1970 Plan and the stock options under the 1971 Plan. In addition, since March 14, 1973, holders of the options under the 1971 Plan are not entitled to exercise such options but receive the equivalent, in stock and/or cash, of the difference between the option price and fair market value at time of surrender of the option. No more than 50% of the shares covered by any option can be issued to any optionee in payment for such appreciation, with the balance payable in cash. At December 31, 1974, 422,856 shares of common stock are reserved for issuance under the 1970 and 1971 Plans.

On March 15, 1974, the 1971 Plan was amended to provide that the option price per share of each option outstanding on May 14, 1974 and of each option granted thereafter, would be reduced by an amount equal to the aggregate cash dividends declared and paid on each share of common stock during the period beginning with the later of (a) May 14, 1974 or (b) the date of grant of the option and ending on the date the option is presented for exercise, subject to the limitation that in no event will the option price per share be reduced to less than 50% of the original option price per share or the then par value of each share, whichever is higher. The 1971 Plan is to remain in effect until terminated by the Board, but no options may be granted after February 23, 1980.

The Board of Directors has the power to cancel all or any part of any outstanding option under the 1971 Plan in the event it determines that the ultimate federal income tax consequences or the financial accounting effects of the exercise of options under the plan would not be in the best interests of Cerro.

The option price under all Plans is 100% of the fair market value of the stock on the date of grant. In the years 1974 and 1973, options were granted to purchase 34,750 and 255,591 shares, respectively, under the Plans. In 1974 and 1973 options to purchase 317,712 and 17,779 shares expired, respectively. Details of other transactions for the years 1972, 1973 and 1974 are as follows:

	No. of Shares(a)	Option Price		Market Value	
		Per Share(a)	Amount	Per Share(a)	Amount
<u>Became Exercisable in:</u>					
1972					
1961, 1964, 1970 Plans ...	30,968	\$12.02 to \$23.58	\$ 528,000	\$12.94 to \$16.44(c)	\$ 441,000
1971 Plan .....	34,013	12.94 to 17.25	545,000	12.94 to 16.44(c)	509,000
1973					
1961, 1964, 1970 Plans ...	41,978	12.94 to 25.24	709,000	13.50 to 16.19(c)	629,000
1971 Plan .....	66,851	12.94 to 17.25	1,082,000	13.50 to 16.19(c)	1,027,000
1974					
1970 Plan .....	46,944	12.94 to 25.24	864,000	11.62 to 18.94(c)	771,000
1971 Plan .....	88,360	12.56 to 18.13	1,369,000	11.62 to 18.94(c)	1,422,000

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	No. of Shares(a)	Option Price		Market Value	
		Per Share(a)	Amount	Per Share(a)	Amount
<u>Exercised in:</u>					
1972					
1961, 1964, 1970 Plans ...	None	None	None	None	None
1971 Plan .....	None	None	None	None	None
1973					
1961, 1964, 1970 Plans ... (Granted 1963)	15,407	12.02 to 12.03	185,000	13.94(d)	215,000
1971 Plan .....	None	None	None	None	None
1974					
1964, 1970 Plans .....	None	None	None	None	None
1971 Plan .....	59,345	12.69 to 17.25	921,000(f)	17.00 to 18.94(d)	1,078,000(f)
(Granted in 1971, 1972, 1973 and 1974)					
<u>Outstanding at</u>					
December 31, 1973					
1964, 1970 Plans .....	282,279	12.94 to 25.24	4,870,000	12.94 to 25.24(b)	4,870,000
(Granted in 1969, 1970, 1971, 1972 and 1973)					
1971 Plan .....	413,051	12.94 to 17.25	6,668,000	12.94 to 17.25(b)	6,668,000
(Granted in 1971, 1972 and 1973)					
December 31, 1974					
1970 Plan .....	106,975	13.19 to 18.15	1,793,000	13.19 to 18.15(b)	1,793,000
(Granted in 1970, 1971, 1972 and 1973)					
1971 Plan .....	226,048	12.01 to 17.33(e)	3,385,000	12.56 to 18.13(b)	3,558,000
(Granted in 1971, 1972, 1973 and 1974)					

(a) Adjusted for stock dividends and a stock split.

(b) At dates of grant.

(c) At dates options became exercisable.

(d) At dates exercised.

(e) Adjusted for cash dividends declared and paid subsequent to May 14, 1974.

(f) Optionees received in cash \$157,000 representing excess of market value at date of exercise over option price. Shares available for future options under the 1971 Plan at December 31, 1974 and 1973 were 196,808 shares and 9,805 shares, respectively.

## 11. Shareholders' Equity

Cerro repurchased on the open market in 1974 and 1973, 36,600 and 112,400 shares, respectively.

On September 7, 1973, Cerro made a tender offer to purchase up to 500,000 shares of its common stock at \$15.00 per share. A total of 419,029 or 84% of the original offer, which expired October 15, 1973, were tendered. The shares purchased are being held as treasury stock to be used for general corporate purposes.

Authorized preferred stock of 1,000,000 shares, without par value is unissued.

Reappraisal surplus (\$52,959,000), which arose on the revaluation of Cerro-Peru's mining properties in 1943 and 1951, has been transferred to retained earnings in 1973 to offset the charges to retained earnings for depletion and amortization of appraised values and the write-off of Peruvian assets.

## 12. Real Estate Operations

Cerro's real estate operations are conducted through Leadership Housing, Inc. ("Leadership"), a wholly owned subsidiary. Leadership's revenues from sales declined from approximately \$160

million in 1973 to approximately \$96 million in 1974 resulting in a pre-tax loss of \$13.6 million in 1974 as contrasted with a pre-tax profit of approximately \$11.9 million in 1973.

During 1974 and the first quarter of 1975, Cerro provided Leadership with a total of approximately \$19.9 million in the form of advances and made an additional capital investment in Leadership of \$2.5 million. In addition, during 1974 Cerro deposited \$6.5 million with Leadership's principal lenders in connection with a compensating balance requirement of Leadership under its revolving credit-term loan agreement (the "Loan Agreement") pursuant to which Leadership borrowed \$42,500,000 during 1973 and 1974. Such deposits are not available to satisfy any liabilities of Leadership. Leadership's lenders have (i) waived, as of December 31, 1974 and as of the present time, all defaults under the Loan Agreement and (ii) have modified those covenants with which Leadership has not been able to comply in such a manner as to cause Leadership to be in compliance at the present time.

During early 1975, a contingency plan was proposed to provide Leadership with additional funds and greater freedom of operation under the Loan Agreement. Under terms presently proposed, but subject to the fulfillment of certain conditions beyond the control of Cerro and Leadership, Cerro would purchase certain assets of Leadership for an aggregate purchase price of \$15 million, of which approximately \$5.9 million is expected to be paid in cash, \$3.75 million by issuance of a Cerro note, and \$5.35 million by forgiveness of prior advances. In addition, Cerro would provide \$10 million cash under terms not yet determined. These actions by Cerro, however, are dependent upon agreement being reached with Leadership's principal lenders with respect to the implementation of the contingency plan. The contingency plan would, among other things, including Cerro's proposed actions described above, provide: for an extension of the Loan Agreement; for relief from the rate of interest presently being charged by such lenders; for relief from compensating balance requirements; and, for additional project financing from such lenders and Cerro (see Note 6 to Note 13 hereof for a description of the Loan Agreement). Letters of intent with respect to the plan have not yet been executed. However, in the event such letters of intent are executed and delivered, Cerro intends, based on presently known conditions, to support Leadership's ordinary operations during 1975. It is anticipated that such contingency plan, if effectuated, would provide adequate support to Leadership through 1976 under presently known and anticipated conditions. However, there can be no assurance that Leadership will not require additional funds beyond 1975, even assuming that the foregoing plans are effectuated, and Cerro has no present intention of supplying such additional funds if needed.

In the event such letters of intent are not executed and delivered it is the present intention of Cerro's management not to conclude the purchase of such assets, not to provide the additional \$10 million in cash referred to above, and not to provide further financial support to Leadership except to the extent required by existing legally binding commitments. In this connection, the only legally binding material commitment of Cerro in respect of Leadership is pursuant to a General Agreement of Indemnity whereby Cerro has agreed to indemnify certain insurance companies which have issued surety bonds aggregating \$39.4 million guaranteeing Leadership's performance under certain construction contracts. Should Leadership not be able to perform under such contracts, it is anticipated that Cerro may cause such contracts to be performed by Leadership's subcontractors. Although there may not be any material adverse consequences to Cerro by reason of the General Indemnity Agreement, a substantial amount of construction covered thereby remains incomplete at March 27, 1975.

If Cerro terminates financial support of Leadership, it is not presently anticipated that Leadership will be able to survive as an on-going business. While it is not possible at the present time to predict whether or not any part of Cerro's investment in Leadership would be recovered in the event Leadership ceases to be an on-going business, Cerro's maximum exposure would be the loss of its entire investment in Leadership which, at March 27, 1975 was approximately \$65.0 million plus the cost of performance referred to above.

### 13. Real Estate Financial Statements

Presented below are the condensed financial statements of the real estate operations ("Leadership Housing, Inc."), together with related footnotes.



**STATEMENT OF OPERATIONS**  
**For the Years Ended December 31, 1974 and 1973**

(\$ In Thousands)

	<u>1974</u>	<u>1973</u>
Sales:		
Single family housing .....	\$ 81,098	\$ 84,611
Multi-family housing .....	8,968	32,712
Land sales .....	2,942	30,071
Other .....	2,998	12,555
	<u>96,006</u>	<u>159,949</u>
Other revenue including interest income of \$6,751 and \$5,685 and equity in joint venture income of \$2,214 and \$4,252 in 1974 and 1973, respectively .....	9,055	10,465
	<u>105,061</u>	<u>170,414</u>
Cost of Sales .....	92,767	139,495
Writedowns of inventories and other special charges:		
Single family housing .....	1,700	—
Land sales .....	3,600	—
	<u>98,067</u>	<u>139,495</u>
	8,994	30,919
Selling and administrative expenses .....	12,740	13,789
Interest cost accrued .....	16,321	11,208
Less interest capitalized .....	(8,461)	(5,962)
Income (loss) before income taxes .....	<u>(\$ 13,606)</u>	<u>\$ 11,884</u>

**BALANCE SHEET**  
**For the Years Ended December 31, 1974 and 1973**

(\$ In Thousands)

	<u>1974</u>	<u>1973</u>
ASSETS		
Cash .....	\$ 4,688	\$ 8,031
Notes and other receivables .....	46,885	49,779
Inventories .....	118,262	110,084
Investments in joint ventures .....	11,278	10,923
Property, plant and equipment, net .....	17,951	12,439
Goodwill, less amortization of \$433 and \$244 respectively .....	8,262	8,695
Other assets .....	4,801	4,671
	<u>\$212,127</u>	<u>\$204,622</u>

**LIABILITIES AND SHAREHOLDER'S EQUITY AND ADVANCES**

Notes payable .....	\$115,682	\$ 96,459
Accounts payable .....	9,062	10,163
Accrued liabilities .....	6,786	5,514
Customer deposits .....	6,219	15,749
Rent guarantee reserves .....	2,757	3,098
Estimated cost to complete property sold .....	479	2,562
Deposits on property subject to repurchase .....	7,236	7,524
Deferred income .....	4,403	5,881
	<u>152,624</u>	<u>146,950</u>
Shareholder's equity and advances .....	59,503	57,672
	<u>\$212,127</u>	<u>\$204,622</u>

See Notes to Real Estate Financial Statements

## NOTES TO REAL ESTATE FINANCIAL STATEMENTS

### Note 1 — Summary of Accounting Principles and Policies:

The major accounting principles and methods used by the Company are described below.

#### A. *Recognition of Revenue*

Sales of single family houses and condominiums are recorded when escrow closes and title has passed to the buyer at which time cash has been received for substantially the full sales price. At that time, land costs, allocated site development costs, specific construction costs, related capitalized interest and real estate taxes are relieved from inventory and charged to cost of sales along with a provision for sales commissions and estimated miscellaneous warranty costs. Customer down payments and payments of specified amounts at certain stages of construction prior to closing are recorded as customer deposits.

Sales of recreational facilities, developed and undeveloped land are recorded at the time escrow closes and the Company has received the required cash down payment and all other conditions necessary for profit recognition have been satisfied.

Revenues and profits on sales of land which the Company is required to develop are recognized over the development period in the ratio of costs incurred to estimated total costs at completion providing future costs can be reasonably quantified.

Sales of land whereby the Company intends or is obligated to repurchase such property are treated as financing arrangements and are not recorded as sales. Costs of land and improvements applicable to such sales are included in inventory and cash received from the buyer is recorded as deposits on property subject to repurchase. Notes receivable on such transactions have not been recorded in the balance sheet. Interest received on such unrecorded notes is recorded as additional deposits on property subject to repurchase.

Multi-family projects are generally sold to investors subject to physical construction and minimum cash flow guarantees. Where minimum cash flow guarantees exist, a sale is not recorded until the project achieves a cash flow sufficient to provide for all operating expenses and guarantee requirements. Once this level of operation is achieved, profits are recognized in the ratio of costs incurred to date to estimated total costs at completion over the period of performance including the guarantee period. Costs include anticipated operating expenses of the property during the guarantee period. Anticipated gross rental income during the guarantee period is reduced by an appropriate margin and is recorded as additional rent guarantee reserve. Costs of land and improvements on multi-family projects which have not satisfied all conditions for income recognition are included in inventory, amounts of investors' payments are reflected as deposits and the related notes receivable secured by all-inclusive trust deeds are not recorded on the balance sheet. Certain profits from projects sold in years prior to 1972 which have continuing seller involvement or cash flow guarantees over extended periods up to 30 years have been deferred and included as additional rent guarantee reserve in the accompanying balance sheet.

#### B. *Inventories*

Inventories are carried at cost or market whichever is lower. Land is carried at average cost plus interest and real estate taxes. Site development is at average cost and construction is at specific cost. Single and multi-family inventory consists of land, land improvements, construction costs and other capitalizable costs including interest and real estate taxes for projects currently under development. Land and improvements applicable to single family construction and multi-family projects are transferred to such inventory captions when construction commences.

Consistent with the above method of valuing inventories, the Company has provided for reductions of inventories where appropriate to their estimated net realizable value at December 31, 1974. These adjustments, which management does not expect to recur to the same degree in the future, are shown separately in the statement of operations and there were no material provisions in prior years.

#### C. Property, Plant and Equipment

Property, plant and equipment is carried at cost and is depreciated by the straight-line method over the estimated useful life of the assets. Costs of additions and major improvements are capitalized and expenditures for maintenance and repairs are expensed. When property or equipment is retired or sold, any profit or loss on the transaction is recognized currently.

The Company provides, for a fee, water and sewerage service in certain areas which it has developed. The costs of the utility system are capitalized and depreciated over their estimated useful lives. Revenues and related costs are included in other sales and cost of sales in the consolidated statement of operations.

The estimated useful lives of property, plant and equipment are indicated below:

	Years
Buildings and structures .....	25
Utility system .....	40
Leasehold improvements .....	Term of Lease
Machinery and equipment .....	4
Furniture and fixtures .....	6

#### D. Goodwill

Goodwill arose on the acquisition of Leadership by Cerro Corporation and has been allocated 50% to land and 50% to goodwill. The amount included in land is charged to cost of sales \$1,040,000 in 1974 and \$801,000 in 1973 when land is sold. Goodwill is being amortized over forty years commencing in 1972. Amortization of \$1,483,000 and \$740,000 was charged to operations in the years 1974 and 1973, respectively.

#### E. Deferred Income

Deferred income consists of interest, which is amortized into income over a specified term; deferred profit, which is amortized into income over the construction and guarantee period of multi-family projects; and deferred profit on a sale of land recorded on the installment method.

#### F. Income Taxes

The real estate operations are included in Cerro's consolidated tax return.

#### Note 2 — Receivables

Notes and other receivables consist of the following:

	1974	1973
	(\$ in Thousands)	
Notes		
First trust deeds .....	\$18,807	\$24,823
Secured by all-inclusive trust deeds .....	9,351	10,252
Second trust deeds, net .....	13,153	8,602
	41,311	43,677
Other receivables, less allowance for uncollectibility of \$833 and \$841, respectively .....	5,574	6,102
	<u>\$46,885</u>	<u>\$49,779</u>

First trust deed notes receivable arise from the sales of land and recreational facilities which mature within 10 years for land and 30 years for recreational facilities. Such receivables are secured by the related land and recreational facilities.

Notes receivable secured by all-inclusive trust deeds less underlying trust deed notes payable are due in annual instalments of up to 30 years.

Second trust deeds arise primarily from the sales of single-family residences and certain sales of land. Receivables due from single-family home sales, which are subordinated to first trust deeds held by financial institutions, generally bear interest by their terms at 8% and are due in monthly instalments of principal and interest for periods averaging nine years. The Company has imputed interest on these receivables arising from single-family home sales to yield a 12% effective interest.

Notes and other receivables mature by their terms in varying installments of up to 30 years. At December 31, 1974 and 1973, the net amount due within one year is \$7,143,000 and \$4,698,000, respectively.

At December 31, 1974 and 1973, there are unrecorded notes receivable aggregating \$12,365,000 and \$12,944,000, respectively, which resulted from sales treated as financing arrangements and sales of multi-family projects which have not satisfied all conditions for income recognition. The portion of these notes due within one year aggregates \$2,094,000 and \$4,390,000, respectively. Certain unrecorded notes have been pledged as collateral securing the Company's revolving and term loan.

#### Note 3 — Inventories:

Inventories, substantially all of which are pledged, were comprised of the following:

	1974	1973
	(\$ in Thousands)	
Land and improvement costs .....	\$ 67,494	\$ 49,674
Single-family construction .....	40,291	52,019
Multi-family projects .....	6,675	4,281
Land subject to repurchase .....	3,802	4,110
	<u>\$118,262</u>	<u>\$110,084</u>

#### Note 4 — Investments in Joint Ventures:

The investments in joint ventures consist of the following:

	1974	1973
	(\$ in Thousands)	
Advances: .....		\$ 1,685
Equity in net earnings .....	\$ 6,466	4,252
Note receivable due in annual installments of principal and interest through 1977 .....	4,812	4,986
	<u>\$ 11,278</u>	<u>\$ 10,923</u>

The accounting policies and principles followed by the joint ventures insofar as they relate to revenue and profit recognition are the same as those noted as being followed by the Company.

The Company is a participant in two joint ventures each of which provides for participation in 50% of profits and losses. At December 31, 1974 these two ventures which hold unimproved property have not made any sales. In addition the Company is a participant in another joint venture, which is developing and selling property, in which the Company participates in 50% of profits

only (not losses) for approximately two-thirds of the property being developed and 50% of profits and losses for the other one-third of the property. In all three of these ventures the Company has no obligation to make any capital contributions. However, to the extent the other participants make such contributions preference will be made as to ultimate distributions for such contributions as well as an interest factor thereon.

**Note 5 — Property, Plant and Equipment:**

At December 31, 1974 and 1973 the major classifications of property, plant and equipment (at cost) are as follows:

	1974	1973
	(\$ in Thousands)	
Land and land improvements .....	\$ 1,359	\$ 1,168
Buildings and structures .....	994	1,036
Utility system (pledged) .....	15,060	10,297
Machinery, equipment etc. ....	1,266	1,184
Golf course and related facilities .....	1,042	
	<u>\$19,721</u>	<u>\$13,685</u>
Less accumulated depreciation .....	1,770	1,246
	<u><u>\$17,951</u></u>	<u><u>\$12,439</u></u>

Depreciation amounted to \$514 and \$552 for the years ended December 31, 1974 and 1973 respectively.

**Note 6 — Notes Payable:**

	1974	1973
	(\$ in Thousands)	
Obligations to banks:		
Notes payable — bank revolving and term loan agreement (a) .....	\$ 42,500	\$29,250
Other:		
7% to prime plus 6% real estate mortgages payable in instalments through 1996 .....	68,989	62,737
6-10% unsecured notes payable in installments through 1982 .....	4,193	4,472
	<u>\$115,682</u>	<u>\$96,459</u>

(a) On October 4, 1973, as amended November 1, 1974, the Company entered into an agreement with a group of banks for a one year line of credit aggregating \$42,500,000, which becomes payable in eight quarterly installments beginning January 1976. The loan bears interest at 1½% over a rate, which approximates the prime rate until October 1, 1975 and 1½% over such rate thereafter, payable quarterly. Based on an understanding with the banks the Company has agreed to maintain compensating balances equal to 10% of the aggregate commitment and 10% of the principal amount borrowed. In 1974, Cerro deposited \$6,500,000 with the banks based on the above understanding; this amount has not been recorded by the Company. Cerro is charging the Company interest, for this amount, at approximately 9%.

The credit line is secured by mortgage receivables and the utility system having a collateral value equal to 125% of the aggregate commitment. The Company pays a commitment fee equal to ½ of 1% per annum on the average daily portion of the unused commitment.

The agreement provides, among other things, for minimum tangible net worth maintenance, limitations on indebtedness, and maximum limitations on investments in properties and joint ventures. At December 31, 1974, the Company was not in compliance with the requirements of the agreement (see Note 12).

The Company has additional notes payable secured by multi-family projects, which amounts have been deducted from notes receivable secured by all-inclusive trust deeds on those projects. The principal remedy in the event of default, under such notes, is recourse solely against the property secured thereby through a trustee's sale under provisions of the trust deed. In relatively rare instances, the statutory provisions allowing a deficiency judgment to be obtained through judicial processes are utilized in lieu of the rights under the sale provision of the trust deed. Such judicial processes are rarely used by lenders inasmuch as they may take several years and are subject to a right of redemption by the property owner following a judgment.

Notes payable mature in varying instalments; however, acceleration of payments may be required to release mortgaged property sold.

The following is a debt repayment schedule for the next five years: (\$ in Thousands)

1975	\$45,577	1978	\$ 1,222
1976	\$34,213	1979	\$ 5,428
1977	\$24,142		

#### Note 7 — Commitments and Contingencies:

The Company is liable for obligations in the normal course of business for the completion of contracts relating to construction of houses, purchases of land, improvements of property sold and guarantees to purchasers of apartment projects. In addition, the Company is a defendant in lawsuits arising in the normal course of business which in the opinion of counsel will not have a material effect upon the Company. The Company is obligated for annual rentals under long term leases which in the aggregate are not material.

In connection with a sale of land in 1972 (treated as a financing arrangement for financial statement purposes) the Company is obligated to repurchase such land over a six-year period which began in 1973 at a repurchase price consisting of the Company's selling price, the buyers' development and carrying costs and a premium. The premium remaining to be paid on land not yet repurchased aggregates approximately \$2,180,000.

#### Note 8 — Interest Capitalization:

It has been the Company's historical practice to capitalize interest relating to obligations incurred in connection with land, construction and land improvements. Management believes this policy results in the most appropriate matching of costs and revenues. Had the Company followed the policy of expensing all interest as incurred income (loss) before income taxes would have been (\$18,867,000) in 1974 and \$8,765,000 in 1973.

Interest applicable to other obligations including the revolving and term loan agreement has been expensed as incurred.

# CERRO CORPORATION

(Registrant)

## STATEMENT OF EARNINGS

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

	1974	1973
Net sales .....	\$342,836	\$324,085
Other revenue, including interest of \$9,657 and \$3,989, respectively .....	11,357	4,897
	<u>354,193</u>	<u>328,982</u>
Cost and expenses:		
Cost of products sold .....	284,112	277,073
Selling and administrative expense .....	29,638	31,910
Interest on long-term debt .....	5,331	6,002
Depreciation .....	3,994	3,941
	<u>323,073</u>	<u>318,926</u>
Earnings from continuing operations before taxes and equity in earnings of subsidiaries .....	31,118	10,056
Income taxes (Note R-2) .....	(18,203)	(4,896)
Equity in earnings of subsidiaries, net of tax (Schedule III) .....	3,012	10,018
Earnings from continuing operations .....	15,927	15,178
Earnings from discontinued operations (Note D) .....	—	33,783
Earnings before extraordinary item .....	15,927	49,161
Extraordinary item (Notes C, D and E) .....	—	(45,550)
Net earnings .....	<u>\$ 15,927</u>	<u>\$ 3,811</u>
Earnings per Common Share (in dollars)*:		
Earnings from continuing operations .....	\$2.01	\$1.86
Earnings from discontinued operations .....	—	4.08
Earnings before extraordinary item .....	2.01	5.94
Extraordinary item .....	—	(5.50)
Net earnings .....	<u>\$2.01</u>	<u>\$ .44</u>
Cash dividends .....	\$1.05	\$ .75
* Based upon the weighted average number of shares outstanding during each year (Thousands of Shares) (Note J) .....	7,925	8,273

This statement should be read in conjunction with the accompanying notes prefaced with the letter R — signifying Registrant.

Reference is also made to the Notes to Financial Statements (numerical) and Notes to Summary of Operations (alphabetical) of Cerro Corporation and Consolidated Subsidiaries contained elsewhere herein.

# CERRO CORPORATION

(Registrant)

## STATEMENT OF RETAINED EARNINGS

.( \$ in Thousands)

	Years Ended December 31	
	1974	1973
Balance at beginning of year .....	\$154,323	\$103,939
Add:		
Reappraisal surplus (Note 11) .....	—	52,959
Net earnings .....	15,927	3,611
Cash dividends .....	(8,315)	(6,186)
Balance at end of year .....	<u>\$161,935</u>	<u>\$154,323</u>

## STATEMENT OF PAID-IN CAPITAL

	Years Ended December 31	
	1974	1973
Balance at beginning of year .....	\$178,218	\$178,084
Excess of cash received over par value of common stock issued upon exercise of stock options (1973 — 15,407 shares) .....	—	134
Balance at end of year .....	<u>\$178,218</u>	<u>\$178,218</u>

This statement should be read in conjunction with the accompanying notes prefaced with the letter R — signifying Registrant.

Reference is also made to the Notes to Financial Statements (numerical) and Notes to Summary of Operations (alphabetical) of Cerro Corporation and Consolidated Subsidiaries contained elsewhere herein.



**CERRO CORPORATION**  
(Registrant)

**BALANCE SHEET**  
**December 31, 1974 and 1973**

(\$ in thousands)

ASSETS	1974	1973
Current Assets:		
Cash	\$ 14,026	\$ 11,624
Time and certificates of deposit (includes \$104,000 of restricted deposits in 1974, (Note 3))	113,968	57,013
Marketable securities at cost less reserve of \$2,069 in 1974 — approximately market	41,843	20,620
Receivable from Peru Government (Note D)	—	30,415
Accounts, notes and other receivables, less allowances for doubtful accounts of \$634 in 1974 and \$1,086 in 1973 (Schedules II and XII):		
Trade	23,693	36,697
Chile (Note 5)	4,859	—
Subsidiaries	—	5,338
Other	1,726	1,858
Inventories (Note R-4)	60,536	58,464
Prepaid expenses	674	750
Total current assets	281,325	222,779
Receivable from U. S. Government (Note D)	—	10,000
Notes due from Chile (Note 5)	25,251	35,674
Future income tax benefit (Notes C and D)	38,297	64,800
Investments (Schedule III)	155,793	116,205
Less: reserve (Schedule XII)	(10,145)	(9,855)
Property, plant and equipment, net (Note I and Schedules V and VI)	44,123	42,560
	<u>\$514,844</u>	<u>\$482,163</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
	1974	1973
Current Liabilities:		
Long-term debt due within one year (Note R-5)	\$ 5,344	\$ 4,787
Accounts payable (including in 1974, \$4,726 due subsidiaries) (Note 3)	82,809	30,977
Accrued liabilities:		
Salaries and wages	4,237	2,532
Income tax (Note R-2)	11,130	6,001
Interest	1,390	1,303
Other	10,304	8,437
Total current liabilities	115,214	54,037
Long-term debt (Note R-5)	45,771	71,118
Deferred income taxes (Note C)	—	10,273
Deferred income	560	687
Total liabilities	<u>161,545</u>	<u>136,115</u>
Shareholders' Equity (Notes 9, 10 and 11):		
Common stock, par value \$3.33 1/2 per share, authorized 15,000,000 shares, issued 8,779,654 shares	29,263	29,265
Paid-in capital	178,218	178,218
Retained earnings (Note 9)	181,935	154,323
	369,418	361,806
Treasury shares, at cost, 868,387 and 831,787 shares	(16,319)	(15,758)
Total shareholders' equity	<u>353,099</u>	<u>346,048</u>
	<u>\$514,844</u>	<u>\$482,163</u>

This statement should be read in conjunction with the accompanying notes prefaced with the letter R — signifying Registrant.

Reference is also made to the Notes to Financial Statements (numerical) and Notes to Summary of Operations (alphabetical) of Cerro Corporation and Consolidated Subsidiaries contained elsewhere herein.

# CERRO CORPORATION

(Registrant)

## STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

### SOURCES OF FUNDS

	1974	1973
Earnings from continuing operations .....	\$15,927	\$ 15,378
Continuing operations not (providing) or requiring funds:		
Income taxes not payable due to expropriation loss (Cerro de Pasco) .....	26,503	—
Deferred income taxes, net .....	(10,273)	385
Equity in subsidiaries and affiliates, less dividends .....	(1,752)	(9,465)
Investment reserves .....	290	8,205
Depreciation .....	3,994	3,941
Total funds from continuing operations .....	<u>34,689</u>	<u>18,444</u>
Earnings from discontinued operations (less equity in income of Atlantic Cement of \$1,556 which did not provide funds) .....		32,227
Extraordinary expropriation loss .....	—	(45,550)
Less book value of investment in Cerro de Pasco, net of tax, which did not require funds .....	—	64,897
	<u>—</u>	<u>19,347</u>
Funds from other sources:		
Payment from U. S. Government .....	10,000	—
Reduction in notes due from Chile (includes \$4,859 classified as current) .....	10,423	—
Book value portion of proceeds on sale of Atlantic Cement .....	—	36,374
Long-term borrowing .....	—	23,200
Sale of property, plant and equipment .....	209	248
Other, net .....	(127)	600
Total funds from other sources .....	<u>20,505</u>	<u>60,422</u>
Total sources of funds .....	<u>\$55,194</u>	<u>\$130,440</u>

### USES OF FUNDS

Investments in subsidiaries and affiliates .....	\$37,836	\$ 18,600
Purchase of property, plant and equipment .....	5,766	2,022
Purchase of treasury stock .....	561	8,296
Cash dividends .....	8,315	6,186
Reduction of long-term debt .....	25,347	17,651
Total funds used .....	<u>77,825</u>	<u>52,755</u>
Increase (decrease) in working capital .....	<u>(22,631)</u>	<u>\$ 77,685</u>

# CERRO CORPORATION

(Registrant)

## STATEMENT OF CHANGES IN FINANCIAL POSITION — (Continued)

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

INCREASE (DECREASE) IN WORKING CAPITAL	<u>1974</u>	<u>1973</u>
Cash, deposits and marketable securities .....	\$80,580	\$ 49,767
Receivable from Peru Government .....	(30,415)	30,415
Accounts, notes and other receivables, net .....	(13,615)	(16,236)
Inventories .....	2,072	8,832
Deferred income taxes .....	—	(10,990)
Prepaid expenses .....	(76)	(202)
	<u>38,546</u>	<u>61,586</u>
Long-term debt due within one year .....	(357)	11,575
Accounts payable .....	(51,832)	(2,591)
Accrued liabilities .....	(8,788)	7,115
	<u>(61,177)</u>	<u>18,099</u>
Increase (decrease) in working capital .....	<u>(\$22,631)</u>	<u>\$ 77,685</u>

This statement should be read in conjunction with the accompanying notes prefaced with the letter R — signifying Registrant.

Reference is also made to the Notes to Financial Statements (numerical) and Notes to Summary of Operations (alphabetical) of Cerro Corporation and Consolidated Subsidiaries contained elsewhere herein.

# CERRO CORPORATION

(Registrant)

## NOTES TO FINANCIAL STATEMENTS

### R-1. Pensions

Pension expense charged to earnings from continuing operations was \$1,865,000 and \$1,371,000 for 1974 and 1973, respectively.

See Note 1 to Financial Statements contained elsewhere herein for additional information.

### R-2. Income Taxes

Cerro and its subsidiaries file a consolidated U.S. income tax return. The following is an analysis of the consolidated tax provision and its allocation to Cerro Corporation, equity in the earnings of subsidiaries, discontinued operations and extraordinary item:

	<u>1974</u>	<u>1973</u>
	(\$ in Thousands)	
Current payable:		
United States .....	\$ 2,312*	\$ 4,618
Foreign .....	607	36,788
State .....	4,201	842
Deferred — United States .....	(10,273)	10,020
Future tax benefit .....	26,503	(64,800)
	<u>\$23,350</u>	<u>(\$12,532)</u>

\* Adjustment in 1974 to conform to 1973 tax return as filed.

	<u>1974</u>	<u>1973</u>
	(\$ in Thousands)	
Allocated to:		
Earnings from continuing operations:		
Cerro Corporation:		
United States .....	\$14,762	\$ 4,632
State and foreign .....	3,441	64
	<u>18,203</u>	<u>4,696</u>
Equity in earnings of subsidiaries:		
United States .....	3,780	9,902
State and foreign .....	1,367	778
	<u>23,350</u>	<u>15,376</u>
Earnings from discontinued operations .....	—	36,892
Extraordinary item .....	—	(64,800)
	<u>\$23,350</u>	<u>(\$12,532)</u>

See Note C to Summary of Operations contained elsewhere herein for additional information.

# CERRO CORPORATION

(Registrant)

## NOTES TO FINANCIAL STATEMENTS

### R-3. Supplementary Earnings Statement Information

Supplementary earnings statement information is as follows:

	<u>1974</u>	<u>1973</u>
	(\$ in Thousands)	
Maintenance and repairs .....	\$6,740	\$6,239
Depreciation of property, plant and equipment .....	3,994	3,941
Taxes, other income taxes .....	5,225	4,506
Rents .....	2,377	2,032

NOTE: Royalties, advertising, exploration, research and product development costs were not significant in amount.

### R-4. Inventories

Inventories, at the lower of cost or market, were comprised of the following:

	<u>1974</u>	<u>1973</u>
	(\$ in Thousands)	
Finished goods .....	\$23,457	\$15,246
Work-in process .....	15,515	18,080
Raw materials .....	19,862	23,713
Operating supplies .....	1,702	1,425
	<u>\$60,536</u>	<u>\$58,464</u>

Inventories of \$49,632,000 at December 31, 1972 were used in determining cost of products sold for 1973.

See Note 1 to Financial Statements contained elsewhere herein for additional information.

### R-5. Long-term Debt

	<u>Interest Rate</u>	<u>Due</u>	<u>1974</u>	<u>1973</u>
			(\$ in Thousands)	
Promissory notes to institutions (a) .....	6½%	1975-1987	\$28,000	\$28,000
Promissory notes to an institution (b) .....	6%	1975-1981	10,500	12,000
Promissory notes to European banks .....	8%	1978	—	20,000
Subordinated promissory notes to an individual (c) .....	12%	1975-1984	11,468	12,071
Other .....	5-6½%	1975-1990	3,147	3,834
			<u>51,115</u>	<u>75,905</u>
Less: Current portion .....			5,344	4,787
			<u>\$45,771</u>	<u>\$71,118</u>

Payable in annual installment of:

(a) \$2,000,000 (b) \$1,500,000 (c) \$1,207,000

See Note 9 to Financial Statements contained elsewhere herein for additional information.

## CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

## SCHEDULE II — ACCOUNTS RECEIVABLES FROM DIRECTORS, OFFICERS AND EMPLOYEES

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C	Col. D	Col. E	
Name of Debtor	Balance at Beginning of Period	Additions	Deductions Amounts Collected	Balance at End of Period Current	Not Current
1974:					
Accounts Receivable — Other Directors, Officers and Employees:					
H. M. Lasky .....	\$42	\$—	\$42	\$—	\$—
L. B. Rubin .....	42	—	42	—	—
	<u>\$84</u>	<u>\$—</u>	<u>\$84</u>	<u>\$—</u>	<u>\$—</u>
1973:					
Accounts Receivable — Other Directors, Officers and Employees:					
R. H. Cutler (1) .....	\$47	\$—	\$47	\$—	\$—
H. M. Lasky .....	—	42	—	42	—
L. B. Rubin .....	—	42	—	42	—
	<u>\$47</u>	<u>\$84</u>	<u>\$47</u>	<u>\$84</u>	<u>\$—</u>

## NOTE:

(1) Earns interest at 5% per annum.

## CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT  
(Excludes Real Estate Operations)

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C		Col. D	Col. E	Col. F
Classification	Balance at Beginning of Period	Additions at Cost		Retirements	Other Changes	Balance at End of Period
		Acquisitions	Other			
1974:						
Land and buildings .....	\$ 30,817	\$ 5,244	\$ 3,364	\$ 45	\$1,461	\$ 40,841
Machinery and equipment .....	66,714	13,037	1,871	1,061	3,913	84,474
Mining properties .....	—	29,391	784	—	1,811	31,966
Revenue equipment, etc. ....	14,855	358	7,782	1,801	—	21,194
Construction in progress .....	722	638	3,674	81	(1,225)	3,728
	<u>\$113,108</u>	<u>\$48,668 (2)</u>	<u>\$17,453</u>	<u>\$2,968</u>	<u>\$5,960 (1)</u>	<u>\$182,203</u>
1973:						
Land and buildings .....	\$ 28,957	\$ —	\$ 1,418	\$ 341	\$ 783	\$ 30,817
Machinery and equipment .....	62,357	—	1,369	1,214	4,202 (3)	66,714
Revenue equipment, etc. ....	16,299	—	5,463	3,896	(3,011)(3)	14,855
Construction in progress .....	1,980	—	827	—	(2,085)	722
	<u>\$109,593</u>	<u>\$ —</u>	<u>\$ 9,077</u>	<u>\$5,451</u>	<u>(\$ 111)</u>	<u>\$113,108</u>

## NOTES:

- (1) Transferred from investments as a result of initial consolidation of company in 1974.
- (2) Principally acquisitions of Golconda Corporation and Fetterolf Coal Group (Note F).
- (3) Reclassification between accounts.

CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

REAL ESTATE OPERATIONS

SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C		Col. D	Col. E	Col. F
Classification	Balance at Beginning of Period	Additions at Cost		Sales or Retire- ments	Other Changes (1)	Balance at End of Period
		Acqui- sitions	Other			
1974:						
Land and land improvements .....	\$ 1,168	\$ —	\$ 211	\$ —	(\$ 20)	\$ 1,359
Buildings and structures .....	1,036	—	6	—	(48)	994
Utility system .....	10,297	—	4,763	—	—	15,060
Machinery, equipment, etc. ....	1,184	—	82	—	—	1,266
Golf courses and related facilities ..	—	—	92	—	950	1,042
	<u>\$13,685</u>	<u>\$ —</u>	<u>\$5,154</u>	<u>\$ —</u>	<u>\$882</u>	<u>\$19,721</u>
1973:						
Land and land improvements .....	\$ 1,246	\$ —	\$ 8	\$ 100	\$ 14	\$ 1,168
Buildings and structures .....	1,584	—	35	629	46	1,036
Utility system .....	7,884	—	2,833	—	(420)	10,297
Machinery, equipment, etc. ....	673	—	282	69	298	1,184
Golf courses and related facilities ..	5,573	—	70	5,573	(70)	—
	<u>\$16,960</u>	<u>\$ —</u>	<u>\$3,228</u>	<u>\$6,371</u>	<u>(\$132)</u>	<u>\$13,685</u>
Modular assembly plant at net real- izable value .....	\$ 2,386	\$ —	\$ —	\$2,412	\$ 26	\$ —

NOTE:

(1) Principally reclassifications between accounts or transfer from other accounts.



## CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

SCHEDULE VI — ALLOWANCE FOR DEPRECIATION AND  
AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT  
(Excludes Real Estate Operations)

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F
Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Retirements	Other Changes	Balance at End of Period
1974:					
Land and buildings .....	\$11,477	\$1,234	\$ 28	\$ —	\$12,683
Machinery and equipment .....	39,802	4,370	603	—	43,569
Mining properties .....	—	98	—	—	98
Revenue equipment, etc. ....	5,017	2,476	1,252	—	6,241
	<u>\$56,296</u>	<u>\$8,178</u>	<u>\$1,883</u>	<u>\$ —</u>	<u>\$62,591</u>
1973:					
Land and buildings .....	\$10,594	\$ 928	\$ 75	\$ 30	\$11,477
Machinery and equipment .....	35,507	3,291	920	1,924	39,802
Revenue equipment, etc. ....	8,373	1,952	3,246	( 2,062)	5,017
	<u>\$54,474</u>	<u>\$6,171</u>	<u>\$4,241</u>	<u>(\$ 108)</u>	<u>\$56,296</u>

CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

REAL ESTATE OPERATIONS

SCHEDULE VI — ALLOWANCE FOR DEPRECIATION AND  
AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F	
Description	Balance at Beginning of Period	Additions		Retirements	Other Changes	Balance at End of Period
		Acquisitions	Charged to Costs and Expenses			
1974:						
Land and land improvements	\$ 3	\$ —	\$ 6	\$ —	\$ —	\$ 9
Buildings and structures	98	—	42	—	2	142
Utility system	744	—	301	—	(75)	970
Machinery, equipment, etc.	401	—	165	—	77	643
Golf courses and related facilities	—	—	—	—	6	6
	<u>\$1,246</u>	<u>\$ —</u>	<u>\$514</u>	<u>\$ —</u>	<u>\$ 10</u>	<u>\$1,770</u>
1973:						
Land and land improvements	\$ 3	\$ —	\$ —	\$ —	\$ —	\$ 3
Buildings and structures	247	—	70	152	(67)	98
Utility system	450	—	245	—	49	744
Machinery, equipment, etc.	291	—	135	60	35	401
Golf courses and related facilities	520	—	102	632	10	—
	<u>\$1,511</u>	<u>\$ —</u>	<u>\$552</u>	<u>\$844</u>	<u>\$ 27</u>	<u>\$1,246</u>

## CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

SCHEDULE XII — VALUATION AND QUALIFYING ACCOUNTS AND RESERVES  
(Excludes Real Estate Operations)

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C	Col. D	Col. E
Description	Balance at Beginning of Period	Additions		Balance at End of Period
		Acquisi- tions	Charged Costs and Expenses	
1974:				
Current Receivables:				
Trade .....	\$1,363	\$118	\$ 597	\$982(1)
Reserve for investments .....	<u>\$9,855</u>	<u>\$ —</u>	<u>\$ 290</u>	<u>\$ —</u>
				<u>\$10,145</u>
1973:				
Current Receivables:				
Trade .....	\$ 983	\$ —	\$ 549	\$149(1)
Reserve for investments .....	<u>\$1,650</u>	<u>\$ —</u>	<u>\$8,205</u>	<u>\$ —</u>
				<u>\$ 9,853</u>

## NOTE:

(1) Uncollectible accounts written off net of recoveries.

CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

REAL ESTATE OPERATIONS

SCHEDULE XII — VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C	Col. D	Col. E
Description	Balance at Beginning of Period	Additions Charged Costs and Expenses	Deductions	Balance at End of Period
1974:				
Allowance for doubtful accounts . . . .	\$841	\$287	\$95	\$833
1973:				
Allowance for doubtful accounts . . . .	\$535	\$181	\$75	\$641

# CERRO CORPORATION AND CONSOLIDATED SUBSIDIARIES

SCHEDULE XIII — CAPITAL SHARES(2)  
as at December 31, 1974

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F	Col. G	
Name of Issuer and Title of Issue	Number of Shares Authorized by Charter	Number of Shares Issued and Not Retired or Cancelled	Number of Shares Included		Shares Issued or Outstanding as shown on or Included in Related Balance Sheet Under Caption "Capital Shares"	Number of Shares held by Affiliates for which Statements are Filed Hereewith	Number of Shares Reserved for Options, Warrants Conversions and Other Rights
			In Col. C Which Are Held by or for Account of Issuer Thereof	Not Held by or for Account of Issuer Thereof			
Cerro Corporation Preferred stock, no par value Common stock, \$.33 3/4 par value	1,000,000	None	None	None	None	None	None
	15,000,000	8,779,654	868,387	7,911,267	8,779,654	None	(1)
ICX Industries, Inc.:							
Common stock, \$.10 par value	2,500,000	2,298,665	200	2,298,465	None	2,180,000	18,405
Colconda Corpora- tion:							
Preferred stock, \$.100 par value	834,406	383,157	—	383,157	None	281,635	None
Common stock, no par value	7,500,000	2,856,845	71,250	2,785,595	None	2,411,425	None

## NOTES:

(1) See Note 10 to Financial Statements.

(2) The capital stock of the consolidated subsidiaries, other than ICX Industries, Inc. and Colconda Corporation, are omitted from this schedule because such subsidiaries are wholly owned. The answer to Column G in respect to such subsidiaries is "None".

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**SCHEDULE III**  
(Registrant)

**CERRO CORPORATION**

Registrant

SCHEDULE III—INVESTMENTS IN, EQUITY IN EARNINGS OF, AND  
DIVIDENDS RECEIVED FROM AFFILIATES AND OTHER PERSONS  
For the Years Ended December 31, 1974 and 1973  
(\$ in Thousands)

Col. A Name of Issuer and Description of Investment	Col. B		Col. C		Col. D		Col. E	
	Balance at Beginning of Period		Additions		Deductions		Balance at End of Period	
	Number of Shares or Principal Amount of Notes	Amount in Dollars	Equity Taken up in Earnings (Losses) of Affiliate and Other Person for the Period	Other	Distribution of Earnings by Persons in Which Earnings (Losses) Were Taken Up	Other	Number of Shares or Principal Amount of Notes	Amount in Dollars (6)
1974		\$ 5,527	\$ 2,769	\$ —	\$ —	\$ —	1,000	\$ 8,296
Cerro Sales Corporation*	1,000						1,000 Common	
Leadership Housing, Inc.*	1,000 Common 40,000 Preferred	47,258	(7,731)	2,500(1)	—	—	1,000 Common 116,950 Preferred	46,516
Richmar Development Cor- poration*(5)	51,950	4,469	—	—	—	—	—	—
Cerro Motor Express Corpo- ration*	1,000	24,922	2,434	—	599	—	1,000	26,757
Cerro International Finance N.V.*	1,000	3,985	—	—	—	—	1,000	3,985
Cerro Spar Corporation*	1,000	5,006	(125)	—	—	3,191 (4)	1,000	1,680
Cerro CATV Devices Inc.*	—	—	(28)	466(2)	—	—	1,000	438
Fetterolf Coal & Construc- tion, Inc.*	—	—	5,585	10,800(2)	—	—	200	16,385
Cerro Purchasing Corpora- tion*	—	—	262	1	—	—	1,000	263
Golconda Corporation (85% owned)	—	—	167	26,624(2)	140	—	2,411,425 Common 281,635 Preferred	26,651
Industrias de Cobre, S.A. (67.3% owned)	114,855	4,728	—	—	354	—	114,855	4,374
Southern Peru Copper Corporation (22¼% owned)	174,084		—	—	—	—	174,084	
Southern Peru Copper Sales Corporation (22¼% owned)	11,125	10,375	—	—	—	—	11,125	13,375
Northwest Iron Co., Ltd. (24% owned)	700,000 Common 3,600,000 Preferred	1,950	—	—	—	—	700,000 Common 3,600,000 Preferred	1,950
Other affiliates, principally foreign	Various	4,955	(331)	1,262	167	626 (3)	Various	5,083
		\$116,205	\$ 3,012	\$41,853	\$1,260	\$ 3,817		\$155,703

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1973

Cerro Sales Corporation*	1,000	\$ 4,230	\$ 1,297	\$ —	\$ —	1,000	\$ 5,527
Leadership Housing, Inc.*	7,878,138 Common 4,123,430 Preferred \$6,000	30,048	5,313	14,105(1)	208	40,000 Preferred	47,258
Richmar Development Corporation*	51,860	4,315	174	—	—	51,860	4,489
Cerro Motor Express Corporation*	1,000	22,186	2,738	—	—	1,000	24,922
Cerro International Finance N.V.*	—	—	(5)	4,000(2)	—	1,000	3,985
Cerro de Pasco Corporation (6)*	150,000 Preferred 800,000 Common	—	—	—	—	—	—
Cerro Spar Corporation*	1,000	1,482	—	3,544(1)	—	1,000	5,008
Industrias de Cobre, S.A. (67.3% owned)	114,855	4,318	588	187	345	114,855	4,728
Atlantic Cement Company, Inc. (50% owned)	75,000	35,318	1,556	—	500	—	—
Compania Minera Andina, S.A. (7)	—	35,833	—	(259)	—	—	—
Southern Peru Copper Corporation (22 3/4 % owned)	174,084	13,375	—	—	—	174,084	13,375
Southern Peru Copper Sales Corporation (22 3/4 % owned)	11,125	—	—	—	—	11,125	—
Northwest Iron Co., Ltd. (24 % owned)	700,000 Common 3,600,000 Preferred	1,850	—	—	—	700,000 Common 3,600,000 Preferred	1,950
Other affiliates, principally foreign	Various	5,987	(65)	15	—	Various	4,955
		<u>\$159,132</u>	<u>\$11,574</u>	<u>\$21,582</u>	<u>\$1,053</u>	<u>\$75,040</u>	<u>\$118,205</u>
	Continuing operations		<u>\$10,018</u>				
	Discontinued operations		1,556				
			<u>\$11,574</u>				

• 100% owned

NOTES:

1974

NOTES:

1973

- (1) Additional investment.  
(2) Initial investment.  
(3) Sales and repayments, etc.  
(4) Transfers to other accounts.

- (1) Additional investment.  
(2) Initial investment.  
(3) Repayment of notes. The balance of \$4,000,000 of notes was exchanged for 40,000 shares of preferred stock.

- (5) Merged into Leadership Housing, Inc.  
(6) Excludes current amounts due to or due from subsidiaries. At December 31, 1974 approximately \$13,000,000 was due from Leadership Housing, Inc.

- (4) Sales and repayments, etc.  
(5) Company's 50% investment in Atlantic Cement Company, Inc. was sold in 1973. See Note D to Summary of Operations.  
(6) Expropriated by the Government of Peru. See Note D to Summary of Operations.  
(7) Expropriated by the Government of Chile. See Note 5 to consolidated financial statements.  
(8) Reclassification to Notes due from Chile.

# SCHEDULE III (Registrant)

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Schedule V  
(Registrant)

CERRO CORPORATION

(Registrant)

SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F
Classification	Balance at Beginning of Period	Additions at Cost	Retirements	Other Changes — Add (Deduct)	Balance at End of Period
<b>1974:</b>					
Land and buildings .....	\$26,737	\$2,022	\$ 32	\$ 54	\$28,781
Machinery and equipment .....	64,775	841	511	615	65,720
Construction in progress .....	488	2,903	81	( 669)	2,841
	<u>\$92,000</u>	<u>\$5,766</u>	<u>\$ 624</u>	<u>(\$ — )</u>	<u>\$97,142</u>
<b>1973:</b>					
Land and buildings .....	\$26,791	\$ 192	\$ 50	(\$ 196)	\$26,737
Machinery and equipment .....	61,239	1,235	1,097	3,398 (1)	64,775
Other equipment .....	2,257	—	—	( 2,257)(1)	—
Construction in progress .....	1,002	595	—	( 1,109)	488
	<u>\$91,289</u>	<u>\$2,022</u>	<u>\$1,147</u>	<u>(\$ 184)</u>	<u>\$92,000</u>

NOTE:

(1) Reclassification between accounts.

CERRO CORPORATION

(Registrant)

SCHEDULE VI — ALLOWANCES FOR DEPRECIATION AND  
AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT

For the Years Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F
Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Retirements	Other Changes — Add (Deduct)	Balance at End of Period
1974:					
Land and buildings .....	\$10,927	\$ 874	\$ 28	—	\$11,773
Machinery and equipment .....	38,513	3,120	387	—	41,246
	<u>\$49,440</u>	<u>\$3,994</u>	<u>\$415</u>	—	<u>\$53,019</u>
1973:					
Land and buildings .....	\$10,122	\$ 804	\$ 31	\$ 32	\$10,927
Machinery and equipment .....	34,697	2,992	868	1,692 (1)	38,513
Other equipment .....	1,682	145	—	(1,827)(1)	—
	<u>\$46,501</u>	<u>\$3,941</u>	<u>\$899</u>	<u>(\$ 103)</u>	<u>\$49,440</u>

NOTE:

(1) Reclassification between accounts.

CERRO CORPORATION

(Registrant)

SCHEDULE XII — VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

For the Year Ended December 31, 1974 and 1973

(\$ in Thousands)

Col. A	Col. B	Col. C	Col. D	Col. E
Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Deductions	Balance at End of Period
1974:				
Current receivables:				
Trade .....	\$1,088	\$ —	(\$452)(1)	\$ 634
Reserve for investments .....	\$9,855	\$ 290	\$ —	\$10,145
1973:				
Current receivables:				
Trade .....	\$ 907	\$ 289	(\$110)(1)	\$ 1,086
Reserve for investments .....	\$1,650	\$8,205	\$ —	\$ 9,855

NOTE:

(1) Uncollectible accounts written off net of recoveries.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended March 31, 1976 Commission File Number 1-7285

Cerro-Marmon Corporation  
(Exact name of registrant as specified in its charter)

<u>Delaware</u>	<u>52-104-5483</u>
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

<u>39 South LaSalle Street, Chicago, Illinois</u>	<u>60603</u>
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (312) 372-9500

Not Applicable  
Former name, former address and former fiscal year, if changed  
since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No     

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET (NOTES 1, 2 AND 3)

March 31, 1976  
(In thousands of dollars)  
(Unaudited)

ASSETS

Current Assets:

Cash	\$ 20,244
Marketable securities, less allowance of \$ 1,881	37,685
Receivables, less allowance of \$3,129	115,447
Inventories (Note 4)	155,286
Other current assets	<u>10,562</u>

Total Current Assets 339,224

Notes due from Chile	10,992
Leadership Housing, Inc. (Note 5)	(1,090)
Property, plant and equipment, less accumulated depreciation of \$28,844	127,394
Other assets	<u>16,388</u>

\$ 492,908

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:

Notes payable	\$ 11,728
Current maturities of long-term obligations	12,715
Accounts payable	53,336
Income taxes (Note 6)	19,570
Accrued liabilities	<u>38,781</u>

Total Current Liabilities 136,130

Long-term debt (Note 7)	127,926
Lease-purchase obligations (Note 7)	17,614
Other noncurrent amounts	10,201
Commitments and contingent liabilities (Notes 6 and 8)	<u>-</u>

291,871

Stockholders' Equity:

Preferred stock (liquidation preference and redemption value of \$95,149) (Note 9)	89,781
Common stock (Note 9)	5,000
Other paid-in capital	10,493
Retained earnings (Notes 7 and 9)	<u>95,763</u>

Total Stockholders' Equity 201,037

\$ 492,908

See accompanying notes.

LS 000693

CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF INCOME (NOTES 1, 2 AND 3)

Three months ended March 31, 1976 and 1975  
(In thousands of dollars)  
(Unaudited)

	<u>1976</u>	<u>1975</u>
Revenues:		
Net sales	\$ 202,284	\$ 67,116
Miscellaneous - net	<u>1,212</u>	<u>236</u>
	203,496	67,352
Costs and expenses:		
Cost of product sold	178,562	52,482
Selling and administrative	10,370	6,833
Interest	<u>2,170</u>	<u>2,221</u>
	<u>191,102</u>	<u>61,536</u>
Income before amounts shown below	12,394	5,816
Income taxes (Note 6)	<u>(6,270)</u>	<u>(3,122)</u>
Income before equity in net income of Cerro	6,124	2,694
Equity in net income of Cerro (Note 3c)	<u>1,782</u>	<u>3,295</u>
Net income (Note 3c)	7,906	5,989
Net income applicable to preferred stock (Note 10)	<u>(1,001)</u>	<u>-</u>
Net income applicable to common stock (Note 10)	<u>\$ 6,905</u>	<u>\$ 5,989</u>

See accompanying notes.

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (NOTES 1, 2 AND 3)

Three months ended March 31, 1976  
(In thousands of dollars)  
(Unaudited)

	Preferred stock (Note 9)	Common stock (Note 9)	Other paid-in capital	Retained earnings	Total
Balance at January 1, 1976	\$	\$ 1	\$ 12,027	\$ 88,858	\$100,886
Excess of par value of Cerro-Marmon common stock issued to GL over par value of Marmon common stock		4,999	(4,999)		
Value of preferred stock issuable to Cerro stockholders	89,743				89,743
Contribution by GL (Note 8)			2,588		2,588
Elimination of Marmon deferred income tax applicable to its equity in undistrib- uted net income of Cerro			877	(963)	877 (963)
Preferred dividends declared				(38)	
Accrual of redemption value of preferred stock (Note 10)	38			7,906	7,906
Net income					
Balance at March 31, 1976	<u>\$ 89,781</u>	<u>\$ 5,000</u>	<u>\$ 10,493</u>	<u>\$ 95,763</u>	<u>\$201,037</u>

See accompanying notes.

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CHANGES  
IN FINANCIAL POSITION (NOTES 1, 2 AND 3)

Three months ended March 31, 1976  
(In thousands of dollars)  
(Unaudited)

Sources of working capital:		
Total provided by operations		\$ 9,787
Merger of Cerro at February 24, 1976 (Note 3) -		
Preferred stock issuable	\$ 89,743	
Marmon's basis in 45.33% of Cerro	80,028	
Long-term debt assumed	89,252	
Other - net	12,043	
	<u>271,066</u>	
Less cost assigned to noncurrent assets	<u>106,246</u>	
Total provided by merger of Cerro		164,820
Proceeds from long-term obligations		1,250
Decrease in Chilean notes		<u>2,515</u>
Total working capital provided		178,372
Dispositions of working capital:		
Additions to property, plant and equipment	\$ 3,540	
Reduction in long-term obligations (Note 7)	26,305	
Increase in other assets	5,569	
Other	<u>2,154</u>	
Total working capital used		<u>37,568</u>
Increase in working capital		140,804
Working capital at January 1, 1976		<u>62,290</u>
Working capital at March 31, 1976		<u><u>\$ 203,094</u></u>

See accompanying notes.

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CERRO-MARMON CORPORATION  
CONDENSED NOTES TO THE  
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 1976

(Unaudited)

1. Organization

Cerro-Marmon Corporation (Cerro-Marmon) was incorporated on November 21, 1975 and was inactive until February 24, 1976. On that date (1) Cerro-Marmon issued 5 million common shares to GL Corporation (GL) for all of the outstanding common shares of The Marmon Group, Inc. (Michigan) (Marmon), in a transaction accounted for as if it was a pooling of interests, and (2) Cerro-Marmon issued preferred stock to holders of Cerro Corporation (Cerro) common stock, other than Marmon, on a share-for-share basis, and Cerro was merged into Cerro-Marmon in a transaction accounted for as a purchase. Cerro common stock owned by Marmon, representing 45.33% of the Cerro common stock outstanding, was cancelled. See Note 3 for information concerning the accounting for the purchase of Cerro and the allocation of the purchase cost to Cerro's net assets. As a result of the above described transactions, GL owns 100% of the outstanding Cerro-Marmon common stock which represents approximately 82% of the total voting interest in Cerro-Marmon and Marmon is a wholly-owned subsidiary of Cerro-Marmon.

2. Basis of the financial statements and consolidation policy

The consolidated financial statements for periods prior to February 25, 1976 consist of the historical financial statements of Marmon and all subsidiaries, including Marmon's 45.33% interest in Cerro accounted for on the equity method.

The consolidated financial statements as of dates and for periods subsequent to February 24, 1976 include the accounts of Cerro-Marmon and all subsidiaries (including the former Cerro businesses and subsidiaries) except Leadership Housing, Inc. (Leadership) and certain immaterial foreign subsidiaries.

Cerro-Marmon's investment in Leadership is included in the consolidated balance sheet at an amount determined after giving effect to a reserve for losses established in the allocation of Cerro-Marmon's purchase cost of Cerro to this investment. No amounts applicable to Leadership are included in the consolidated statement of income subsequent to February 24, 1976 as all net gains or losses from Leadership's operations and from intercompany

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transactions with Leadership (including income taxes related thereto), for a two-year period (or appropriate shorter period), will be credited or charged to the aforementioned reserve for losses. See "Leadership Housing, Inc." in Note 3b as to the allocation of purchase cost to the investment in Leadership and Note 3c as to the treatment of Leadership for purposes of determining Marmon's equity in Cerro prior to February 25, 1976.

3. Acquisition of Cerro

a. Acquisition transactions -

Effective August 1, 1974, Marmon acquired 3,586,297 common shares of Cerro, a 45.33% equity interest, at a total cost of \$67,846,000. Of the shares acquired, 813,100 shares were acquired from GL at GL's cost of \$14,031,000 and the remaining shares were acquired pursuant to a cash tender offer. The shares acquired from GL were purchased by GL principally during the period February-May 1974.

On February 24, 1976, Cerro was merged into Cerro-Marmon (Note 1). Pursuant thereto, the former common stockholders of Cerro, other than Marmon, became entitled to receive one share of Cerro-Marmon \$2.25 Cumulative Series A Preferred Stock (Note 9) for each share of Cerro common stock. A total of 4,324,970 shares are issuable, which includes such shares, not as yet determined, applicable to former Cerro stockholders who will be paid in cash pursuant to their perfected dissenters' rights. The preferred shares issuable were valued by the Board of Directors of Cerro-Marmon at \$20.75 per share, based on an estimated fair value of the preferred stock determined when the exchange ratio was approved by the Board of Directors of Cerro.

The above described transactions have been accounted for as a purchase of Cerro by Cerro-Marmon. Accordingly, the net assets of the businesses formerly conducted by Cerro included in the consolidated balance sheet of Cerro-Marmon reflect amounts determined after giving effect to a preliminary allocation of Cerro-Marmon's purchase cost to such net assets. THE RESULTS OF SUCH PRELIMINARY ALLOCATION ARE SUBJECT TO CHANGE TO REFLECT ADDITIONAL INFORMATION OBTAINED AND REALIZATION OF ANY BENEFITS FROM CERRO'S PRIOR INCOME TAX LOSSES.

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b. Purchase cost allocation -

The amount at which Cerro's net assets at February 24, 1976 were included in the Cerro-Marmon balance sheet at that date was determined as follows, in millions:

Applicable to 45.33% interest -

Cost to Marmon	\$ 67.8
Equity in Cerro's undistributed net income	<u>12.3</u>
Marmon's basis in 45.33% of Cerro at February 24, 1976	\$ 80.1

Applicable to 54.67% interest -

Value of preferred stock issuable	\$ 89.7
Acquisition costs	1.5
Proposed litigation settlement costs to be paid by GL (Note 8)	<u>2.6</u>
Cerro-Marmon's cost of 54.67% of Cerro	<u>93.8</u>

Cerro-Marmon's basis in net assets of Cerro at February 24, 1976	<u>\$173.9</u>
--	----------------

The allocations of purchase cost to Cerro's net assets were made as of August 1, 1974 as to the 45.33% interest in Cerro acquired as of that date and as of February 24, 1976 as to the 54.67% interest in Cerro acquired as of that date. The effect of the purchase cost allocation was to significantly reduce the amounts at which Cerro's net assets are included in the Cerro-Marmon consolidated balance sheet from amounts previously reflected in Cerro's historical consolidated balance sheet. A comparison of such amounts as of February 24, 1976 follows, in millions:

	<u>Cerro</u>	<u>Cerro-Marmon</u>
Current assets	\$ 315.6	\$ 315.6
Current liabilities	<u>149.3</u>	<u>149.3</u>
Working capital	166.3	166.3
Leadership Housing, Inc.	34.6	(1.9)
Notes due from Chile	12.0	13.5
Future income tax benefit	34.5	-
Investments and other assets	16.8	2.0
Property, plant and equipment	155.7	90.7
Operating rights and goodwill	<u>19.6</u>	<u>2.1</u>
	439.5	272.7
Less:		
Long-term debt	91.4	89.3
Other non-current amounts	<u>6.3</u>	<u>9.5</u>
Net assets	<u>\$ 341.8</u>	<u>\$ 173.9</u>

LS 000699

As required by generally accepted accounting principles, purchase cost was allocated to Cerro's net assets as of the two purchase dates. This allocation was made on the following bases:

Net current assets -

Cost was allocated in amounts equal to Cerro's book values as such amounts were estimated to approximate fair values.

Notes due from Chile (long-term portion) -

Cost was allocated equal to Cerro's book value as to the 45.33% interest and equal to the face value of the notes, less applicable income tax effect, as to the 54.67% interest.

Investments and operating rights, net -

No cost was allocated to these assets since appraisal values are difficult to obtain because of their unique nature. To the extent additional data as to their value becomes available, purchase cost will be allocated.

Leadership Housing, Inc. (Net realty assets) -

As more fully explained in Note 5, it is the present intention of management to reduce substantially the business, operations and debt levels of the real estate subsidiary, Leadership, through an orderly liquidation of inventories designed to minimize losses. This liquidation may take place while adverse market conditions prevail, creating an uncertainty as to the amount and timing of the ultimate net realizable value of the real estate inventories.

Other actions may be taken in the future with respect to the realty operations as management continues to evaluate its alternatives. However, future actions that might be taken, if any, and the financial effects thereof are not predictable at this time because of the conditions in the real estate markets in which Leadership operates and uncertainties as to future market conditions, the availability of buyers for Leadership's extensive realty inventories and the amounts that might be realized from disposition of the realty inventories under the various conditions under which they might be sold.

Because of the present conditions in Leadership's real estate markets and the existing uncertainties, it is not possible at this time to determine a final amount of purchase cost to be allocated to the individual realty assets, principally realty inventories. Therefore, purchase cost has been tentatively allocated to the net realty assets as a group in an amount approximately equal to Cerro's net investment in Leadership less a reserve for future realty losses. The amount of the reserve is

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approximately equal to the sum of Cerro's equity in and advances to Leadership, debt obligations to Leadership, and commitments to advance additional funds to Leadership at dates of acquisition (See Note 5). All net gains or losses from Leadership's operations and from intercompany transactions with Leadership (including income taxes related thereto) for a two-year period (or appropriate shorter period) will be credited or charged to such reserve. It is expected that present uncertainties concerning the realty operations will be resolved during this period. Any adjustment of the carrying value of the net investment in Leadership necessary at the conclusion of this period, after allocation of purchase cost to the individual realty assets, will be applied to adjust the purchase cost allocated to property, plant and equipment (any credit adjustment applicable to the 45.33% interest will be classified as a deferred credit). See Note 5 as to the carrying value of Leadership in the Cerro-Marmon consolidated balance sheet at March 31, 1976 and for further information concerning Leadership.

**Future income tax benefit -**

No cost has been allocated to this asset. Future income tax benefits realized applicable to the 54.67% interest will be applied to reduce the purchase cost allocated to property, plant and equipment and benefits realized applicable to the 45.33% interest will be classified as a deferred credit.

**Liabilities (long-term) -**

Cerro's book values were considered to approximate fair values with the following exceptions:

- A. Certain long-term debt was reduced to reflect present value amounts based on current interest rates in excess of actual rates.
- B. A provision was made for Cerro's unfunded vested pension benefits.
- C. Deferred income was eliminated.

These adjustments were further adjusted for income tax effects.

**Property, plant and equipment - net -**

After all allocations explained above were made, the residual purchase cost was allocated to property, plant and equipment (no purchase cost was allocated to property, plant and equipment as to the 45.33% interest).

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c. Effect of purchase cost allocation on reported income -

The purchase cost allocations had the effect of significantly increasing the amount reflected by Marmon as its equity in the net earnings of Cerro prior to February 25, 1976 and the net earnings of Cerro-Marmon subsequent thereto. This effect (resulting principally from (1) reductions in depreciation and amortization relating to the reduced carrying value of property, plant and equipment and intangible assets and (2) reduction or elimination of losses from Leadership's real estate operations) was approximately \$1,100,000 in the three months ended March 31, 1975, and approximately \$850,000 in the period January 1, 1976 to February 24, 1976 applicable to Marmon's 45.33% equity in net earnings of Cerro and approximately \$650,000 in the period February 25, 1976 to March 31, 1976. SUCH AMOUNTS ARE SUBJECT TO RETROACTIVE ADJUSTMENT TO REFLECT THE EFFECTS OF ANY CHANGES MADE TO THE ALLOCATION OF PURCHASE COST AND THE EFFECTS OF ANY REALIZATION OF BENEFITS FROM CERRO'S PRIOR INCOME TAX LOSSES.

For purposes of determining Marmon's equity in Cerro's net earnings, losses of Leadership were adjusted to reflect the effects of the purchase cost allocation to the investment in Leadership. These adjustments in the three months ended March 31, 1975 consisted principally of the elimination of direct losses from realty sales and write-downs (no such adjustments were required in the period January 1, 1976 to February 24, 1976). Effective February 25, 1976, the accounting for the 45.33% interest in Leadership's operations was conformed to the accounting, discussed in Note 2, adopted for the 54.67% interest acquired on February 24, 1976. The effect of this change in estimate on Cerro-Marmon's consolidated net income subsequent to February 24, 1976 was not material as to Cerro-Marmon's consolidated net income for the three months ended March 31, 1976.

The treatment followed by Marmon for purposes of determining its equity in Cerro's earnings was deemed appropriate based on information known at the time of adoption. However, the present status of Leadership and the uncertainties relating to its operations, as discussed in Note 5, indicate that the treatment adopted by Cerro-Marmon is more reflective of the present circumstances and will result in consolidated operating results that are more reflective of the effects of the purchase of Cerro at an amount substantially less than Cerro's historical net asset value.

4. Inventories

The last-in, first out (LIFO) cost of inventories (approximately 25% of inventories included in the accompanying condensed consolidated balance sheet) valued under this method was approximately \$26 million less than the approximate current cost

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(determined principally on the basis of standard costs) of these inventories.

Inventories consist of the following, in thousands:

Refined metals and minerals	\$ 42,420
Manufacturing inventories	108,510
Operating supplies	<u>4,356</u>
	<u>\$ 155,286</u>

It is not practicable to classify manufacturing inventories by stage of production.

5. Leadership Housing, Inc.

Cerro-Marmon's investment in Leadership, a nonconsolidated real estate subsidiary, is included in the condensed consolidated balance sheet at Cerro-Marmon's equity in Leadership's net assets less a reserve for future losses (see Notes 2 and 3). Details of such investment at March 31, 1976 follow, in thousands:

Cerro-Marmon's investment - net	\$ 34,980
Less reserve for losses	<u>(36,070)</u>
Net carrying value	<u><u>\$ ( 1,090)</u></u>

The reserve for losses was established through the purchase cost allocation procedures described in Note 3b. Changes in the reserve from February 25, 1976 to March 31, 1976 were as follows, in thousands:

Balance at February 25, 1976	\$ 36,480
Net loss for the period, as reported by Leadership	( 789)
Other	<u>379</u>
Balance at March 31, 1976	<u><u>\$ 36,070</u></u>

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a. Condensed consolidated financial statements of Leadership as of March 31, 1976 and for the period February 25, 1976 to March 31, 1976 follow:

BALANCE SHEET  
(In thousands of dollars)

Assets

Cash	\$ 1,294
Receivables	34,931
Inventories	111,460
Investments in joint ventures	7,703
Other assets	<u>6,393</u>
	<u>\$ 161,781</u>

Liabilities

Notes payable	\$ 97,476
Accounts payable and accrued liabilities	13,252
Deposits	13,098
Other	<u>2,975</u>
	<u>\$ 126,801</u>

Cerro-Marmon's investment - net

Notes, advances and other payables	\$ 26,080
Notes and other receivables	<u>(7,044)</u>
Amount due to Cerro-Marmon - net	<u>19,036</u>
Preferred stock, Series A	11,695
Common stock and additional paid-in capital	41,250
Accumulated deficit	<u>(37,001)</u>
Cerro-Marmon's equity	<u>15,944</u>
Cerro-Marmon's investment - net	<u>\$ 34,980</u>

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STATEMENT OF OPERATIONS  
(In thousands of dollars)

Sales		\$	1,877
Interest and other revenue			<u>771</u>
			2,648
Costs and expenses:			
Cost of sales	\$	1,804	
Selling and administrative		605	
Interest, net of capitalized		<u>1,028</u>	
			<u>3,437</u>
Net loss	\$		<u><u>789</u></u>

b. On August 13, 1975, management stated its intention to reduce substantially the business, operations and debt levels of Leadership, through an orderly liquidation of inventories designed to minimize losses. It is expected that, after this reduction is completed, the total assets of Leadership would be less than half of its total assets at December 31, 1974. As a result of the condition of the real estate market existing in the United States generally, and in Florida in particular, an orderly liquidation of inventories designed to preserve corporate assets is likely to take several years. This liquidation may take place while adverse market conditions prevail. To the extent the reduction results in the disposition of inventories other than in the normal course of business and during a period in which adverse market conditions prevail, the estimated net realizable value may be adversely affected by an undeterminable amount.

Leadership has historically utilized its own sales transactions, as well as sales of comparable land and improvements by others, as one of the primary factors in the determination of estimated net realizable value. Based upon information available in 1975, Leadership has made a determination of net realizable value which resulted in provisions for writedown of inventories at December 31, 1975. However, the decline in comparable transactions together with adverse market conditions and the inventory reduction plan mentioned above have created significant uncertainties with respect to Leadership's determination of estimated net realizable value. Accordingly, uncertainties are created as to the amount and timing of the ultimate realization upon disposition of land and improvement inventories carried on the books of Leadership (\$75,175,000 at March 31, 1976).

The estimated net realizable value of unimproved property (\$31,123,000 at March 31, 1976) held by the two joint ventures in which Leadership is a participant with the Pritzker Trusts (see e.

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of this note) is subject to the same uncertainties as described in the preceding paragraph. While Leadership has no investment in these particular ventures, it is contingently liable to lenders with respect to approximately \$18.7 million of notes payable of the ventures at March 31, 1976.

Events of Default existed at March 31, 1976 under certain of the covenants in the Loan Agreement of Leadership. Leadership anticipates that additional Events of Default may occur in 1976 as a result of continuing unprofitable operations, which may be affected by the outcome of litigation involving certain receivables aggregating \$1,565,000, the ultimate collectibility of which can not presently be determined. If Events of Default occur, the Loan Agreement provides that, upon notification from the principal lenders, the debt covered thereby would become due and payable. Discussions have begun to renegotiate the existing Loan Agreement, the outcome of which cannot be determined at this time.

Cerro financially supported the operations of Leadership during 1975; however, no decision has been reached as to how long Cerro-Marmon will continue its support if Leadership's current operating losses continue and the Loan Agreement does not provide adequate support during the orderly liquidation period described above, or the principal lenders withdraw their support. Cerro-Marmon also has legally binding commitments in connection with surety bonds (approximately \$34 million at March 31, 1976) guaranteeing Leadership's performance under certain construction contracts. A substantial amount of work has been performed under such contracts, but it is not possible to predict the cost to Cerro-Marmon, if any, under the surety bonds.

c. Inventories, at the lower of cost to Leadership or estimated net realizable value, at March 31, 1976 consist of the following, in thousands:

Land and improvement costs*	\$ 75,175
Single family construction	20,657
Multi-family projects	11,826
Land subject to repurchase from Pritzker	
Trusts (see e. of this Note)	<u>3,802</u>
	<u>\$ 111,460</u>

\* Includes \$2,002,000 for properties in the process of foreclosure.

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d. Notes payable at March 31, 1976 consist of the following, in thousands:

Obligations to banks*	\$ 44,188
Real estate mortgages, 7% to prime plus 5.5%, due to 2011	51,159
Unsecured notes, 6-8%, due to 1982	<u>2,129</u>
	<u>\$ 97,476</u>

\* Borrowed pursuant to an Amended and Restated Loan Agreement ("Agreement") dated April 1, 1975 and evidenced by a \$44,500,000 note due April 1, 1977, subject to acceleration as provided in the Agreement. The note bears interest at the rate of 1-1/4% above the Bank's Alternate Base Rate. Two percent of such interest is payable monthly in cash and the difference between the 2% and the 1-1/4% over the Bank's Alternate Base Rate is accrued until the total accrued interest equals \$5,000,000, after which Leadership shall pay to the Bank in cash the full 1-1/4% above the Bank's Alternate Base Rate. The balance of the accrued interest shall be paid at maturity.

The Agreement provides, among other things, for maintenance of minimum tangible net worth, limitations on the purchase of real estate, the sale of certain assets and investments in new properties or joint ventures. In addition, Leadership is required to maintain certain collateral coverage ratios and meet specified cash flow objectives (based on quarterly projections) which, if not met, could be deemed Events of Default by the Bank.

Generally, loans under the Agreement are secured by the assignment of notes, mortgages and deeds of trust; a pledge of the capital stock of one of Leadership's wholly-owned subsidiaries; the granting to the Bank of a first mortgage on most of Leadership's unencumbered real estate; an agreement to assign notes and mortgages acquired after the closing date; an agreement to grant first mortgages on real estate acquired after the closing date; the assignment of Leadership's beneficial interest in two land trusts; an assignment of its interest in a joint venture and its right to cash distributions from its other two joint ventures; the assignment of Excess Cash Proceeds, as defined, if any, from any future sale of Tamarac Utilities, Inc. by Cerro-Marmon to third parties; and the assignment to the Bank of all of Leadership's rights in a Tax Allocation Agreement dated July 31, 1972. In addition, Leadership has assigned a purchase money note of Cerro-Marmon (\$3,623,000 at March 31, 1976) with all principal prepayments thereon to be applied to the Bank's note. Certain amounts due to Cerro-Marmon by Leadership are subordinated to the Bank's claims.

See b. of this Note regarding possible events of default.

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e. Leadership is liable for obligations in the normal course of business for the completion of contracts relating to construction of houses, purchases of land, improvements or property sold and guarantees to purchasers of apartment projects. In addition, Leadership is a defendant in lawsuits arising in the normal course of business which, in the opinion of management and counsel, will not have a material effect upon Leadership.

In connection with a sale of land in 1972 to the Pritzker Trusts\* (treated as a financing arrangement for financial statement purposes) Leadership is required to repurchase certain land and has an option to repurchase certain other land at a repurchase price consisting of Leadership's selling price to the Trusts, the Trust's development and carrying costs and a premium of \$760 per housing unit. If Leadership fails to make the required repurchases, the Trusts will have a cause of action against Leadership for damages sustained as a result of the breach of contract and, in addition, may terminate all of Leadership's rights under the agreement, including Leadership's option rights, and may set off against a purchase money second mortgage owned to Leadership the difference, if any, between the price at which the Trust sells the property to third parties and the price at which Leadership would have been required to repurchase the property.

At March 31, 1976, Leadership is obligated to repurchase land zoned for 3,721 housing units (on which the premium aggregates approximately \$2,850,000) by June 30, 1977 and has an option to that date to repurchase land zoned for 956 housing units. Deposits of \$7,244,000 made by the Trusts on the land subject to repurchase are included in deposits on the March 31, 1976 condensed consolidated balance sheet.

Leadership is a participant in two joint ventures with the Pritzker Trusts, each of which provides for participation in 50% of profits and losses. At March 31, 1976, these two ventures, which hold unimproved property, have not made any sales. In addition, Leadership is a participant in another joint venture, which is developing and selling property, in which Leadership participates in 50% of profits only (not losses) for approximately 40% of the unsold property being developed at March 31, 1976 and 50% of profits and losses for the other 60% of the property. Leadership also participates in a joint venture in which it participates in 50% of profits and losses.

In all four of these ventures, Leadership has no obligation to make any capital contributions except in the event of dissolution of the ventures. However, to the extent the other participants make such contributions, preference will be made as to ultimate distributions for such contributions as well as an interest factor thereon.

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Receivables at March 31, 1976 include \$1,415,000 due from the Pritzker Trusts. In addition, unrecorded notes of \$2,980,000 at March 31, 1976 are due from the Pritzker Trusts which resulted from sales treated as financing arrangements.

\* The beneficiaries of the Pritzker Trusts are members of the Pritzker family, including J. A. Pritzker and R. A. Pritzker, principal officers and directors of Cerro-Marmon. The Pritzker family is also the beneficial owner of GL.

#### 6. Income taxes

Cerro-Marmon is to be included in the consolidated federal income tax return of GL and, prior to February 25, 1976, Marmon was included in the GL consolidated federal income tax return. Pursuant to a formal tax sharing agreement with GL, federal income taxes of Cerro-Marmon will be determined, in general, as if the former Cerro affiliated tax group and the Marmon affiliated tax group each filed separate consolidated tax returns. Prior to February 25, 1976, federal income taxes of Marmon were determined, in general, as if Marmon and its domestic subsidiaries filed a separate consolidated tax return. Federal income taxes so determined have been paid periodically to GL by Marmon and will be paid periodically to GL by Cerro-Marmon except that (1) the former Cerro affiliated tax group shall not be required to make any tax sharing payments during any taxable period in which Cerro-Marmon has not currently paid all prescribed dividends or made sinking fund payments on its Series A preferred stock and (2) during all other taxable periods the members of the former Cerro affiliated group shall retain, without restriction, 50% of any tax sharing payments that would be due to any member of the GL affiliated group.

As a member of the GL consolidated federal income tax group, Cerro-Marmon (and Marmon prior to February 25, 1976) is contingently liable for the federal income taxes of the other members of the group. GL has indemnified Cerro-Marmon (and Marmon) for any federal income taxes attributable to other members of the group.

Federal income taxes accrued but not yet paid to GL or payments to GL in excess of amounts accrued are included as income taxes or refundable income taxes in the consolidated balance sheet. Interest at 115% of the bank's prime rate is paid or received on differences between payments made and payments due.

At March 31, 1976, Cerro-Marmon has losses (losses of Cerro and its subsidiaries prior to the dates of acquisition of Cerro by Cerro-Marmon) which could result in reductions up to approximately \$35,000,000 in future federal income taxes. Realization of the benefits of such losses will not directly effect the reported net income of Cerro-Marmon as any benefits realized will be credited to balance sheet amounts.

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Provisions for income taxes in the consolidated statement of income for the three months ended March 31, 1976 and 1975 include \$515,000 in 1976 (nominal in 1975) provided in lieu of income taxes and \$242,000 in 1976 and \$293,000 in 1975 of deferred income taxes.

7. Long-term debt and lease-purchase obligations

Details of long-term debt at March 31, 1976 are as follows, in thousands :

Notes due to banks, 1/2% above prime, due to 1981	\$ 39,000
Notes due to institutions, 6%-6-3/8% (discounted to an effective rate of 9.5%), due to 1987	25,900
Notes due to corporations, 9-1/2%, due 1977-1987	35,000
Notes due to individuals, 5% (discounted to an effective rate of 9%), due to 1980	5,916
Subordinated debentures, 7%, due to 1990	3,861
Subordinated notes, 12%, due to 1984	6,519
Other	<u>11,730</u>
	<u>\$ 127,926</u>

\$25,000,000 of notes due to banks by Marmon were prepaid on February 24, 1976 with funds contributed to the capital of Marmon by Cerro-Marmon.

The various debt agreements impose certain restrictions on Cerro-Marmon and certain subsidiaries (including Marmon), including restrictions on the payment of cash dividends and the repurchase of capital stock. Pursuant to provisions of the most restrictive of the agreements, Cerro-Marmon had approximately \$20,000,000 available for the payment of cash dividends and repurchase of capital stock at March 31, 1976.

Details of lease-purchase obligations at March 31, 1976 are as follows, in thousands:

3.5 % to 6.8 %, due to 1988	\$ 4,405
5.25% to 9.5 %, due to 1993	6,820
5% to 7.5 %, due to 1994	5,139
6% to 8.25%, due to 1990	<u>1,250</u>
	<u>\$ 17,614</u>

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Scheduled maturities of the long-term debt and lease-purchase obligations in the five calendar years 1977-1981 are \$21,997,000 in 1977, \$21,006,000 in 1978, \$18,765,000 in 1979, \$18,184,000 in 1980 and \$17,060,000 in 1981. In addition, the notes due to banks included in long-term debt require aggregate annual prepayments (maximum of \$6,000,000 per year) beginning April 1, 1977 based on the consolidated net income of Marmon.

Certain of the long-term debt and all of the lease-purchase obligations are secured by certain property, plant and equipment.

#### 8. Litigation

Cerro-Marmon is subject to the possible effects of various litigation commenced against several defendants, including GL, Cerro and Marmon, in 1975 and 1976, relating principally to the purchase of Cerro stock by Marmon in 1974 and the merger of Cerro into Cerro-Marmon. These actions allege violations of the anti-fraud provisions of the federal securities laws and common law and derivative claims, and various wrongdoings on the part of the various defendants and request various reliefs.

In April 1976, the parties involved in several of the actions agreed to two stipulations of settlement, subject to court approval, whereby (1) GL will pay for the benefit of the defined plaintiff classes (former Cerro common stockholders) up to \$2,550,000 for settlement of the actions, plaintiff's counsels' fees and expenses and other costs, and (2) certain of the defendants, not including Marmon, will pay to Cerro-Marmon \$750,000 (including amounts to be paid for plaintiff's counsels' fees and expenses) for settlement of the derivative claims.

The proposed cost to GL of the payments in (1) above has been reflected in the accompanying financial statements as a contribution to the capital of Cerro-Marmon and as an additional cost of the Cerro common stock acquired (Note 3). The amount to be received by Cerro-Marmon for the settlement of the derivative claims will be reflected in the Cerro-Marmon financial statements upon receipt of the funds with usage limited to payment of regular dividends to the preferred stockholders.

The above described proposed settlement does not include a purported class action relating to the merger of Cerro into Cerro-Marmon filed in February 1976 in New York State Court against several defendants including Marmon, Cerro and Cerro-Marmon. This action is based on several alleged causes of action, and asks that there be an injunction against a merger between Cerro and Cerro-Marmon that will divest the public stockholders from a residual equity position, or on terms other than as are presented to the court and determined by it to be fair and for costs including attorneys' fees to the plaintiffs. The complaint alleges

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(1) no corporate benefit for Cerro in which the public stockholders will share, (2) that the merger will "freeze out" the plaintiff class from Cerro's "residual equity", (3) that the preference stock will not share in the residual equity or possible future growth or improvements in Cerro's financial position, and (4) that certain defendants (some of whom are officers and/or directors of Marmon and Cerro-Marmon) breached their fiduciary duties owed to the public stockholders. Other causes of action allege breaches of fiduciary duties by certain defendants (some of which are officers and/or directors of Cerro-Marmon and Marmon) relating to (1) the \$25,000,000 capital contribution to Marmon by Cerro-Marmon (see Note 7), (2) the adequacy of the payment for the Cerro common shares which is being received by the plaintiff class, (3) preparation of the documentation with respect to the merger and (4) misappropriation of the benefits of the merger to be shared by the plaintiff class. In February 1976, the injunction to stay the merger was denied; this denial has been appealed. An action, substantially similar in all respects to the February 1976 action discussed above, except that it also alleges violation of the anti-fraud provisions of the federal securities law, was subsequently filed in Federal Court in New York.

In the opinion of counsel, the claims in these class actions will not be sustained.

Settlement of certain litigation against Marmon relating to a 1971 merger has been agreed to by the parties, subject to court approval. The maximum amount (\$422,000) to be paid by Marmon under the proposed settlement was reflected in Marmon's consolidated financial statements in 1975.

Other legal actions against Cerro-Marmon or its subsidiaries are not expected to materially effect Cerro-Marmon's consolidated financial statements.

#### **9. Capital stock**

The authorized capital stock of Cerro-Marmon consists of 10,000,000 shares of \$1 par value preferred stock and 10,000,000 shares of \$1 par value common stock.

##### **Preferred -**

At March 31, 1976, 4,324,970 shares of preferred stock were issuable (Note 3a). These shares, designated "\$2.25 Cumulative Series A Preferred Stock", are entitled among other things, to dividends at the annual rate of \$2.25 per share on a cumulative basis, a liquidation preference of \$22 per share plus accrued dividends, and are voting (one vote per share). All or part of the Series A stock may be redeemed by Cerro-Marmon on or

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after April 1, 1981 at \$22 per share plus accrued dividends. Commencing in 1982, 6-2/3% of the Series A shares originally issued are to be redeemed annually until all such shares are redeemed or acquired by Cerro-Marmon. Pursuant to terms of the proposed settlement of certain litigation (Note 8), the annual dividend rate on the Series A stock will be increased to \$2.35 per share beginning 1981.

Common -

At March 31, 1976, 5,000,000 shares of common stock were issued and outstanding (entitled to four votes per share). Further, pursuant to terms of the proposed settlement of certain litigation (Note 8), no payments can be made with respect to the common stock until consolidated stockholders' equity is \$10,000,000 greater than such equity on February 24, 1976. As a result of the above, no amounts are available at March 31, 1976 for payments with respect to the common stock.

10. Net income applicable to preferred and common stock

The amount shown in the consolidated statement of income consists of \$963,000 of accrued dividends on the Series A preferred stock and \$38,000 for the accrual of the excess of redemption value over the value of the Series A preferred stock issuable, both for the period February 25, 1976 to March 31, 1976.

Earnings per common share amounts are not presented as all of the common shares of Cerro-Marmon (and Marmon prior to February 25, 1976) are owned by GL.

11. The accompanying condensed consolidated financial statements include all adjustments which, in the opinion of management, are necessary for a fair presentation of the consolidated financial position, results of operations and changes in financial position.

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Sales of Unregistered Securities (Debt or Equity)

There were no sales of unregistered securities as defined in Section 2 (1) of the Securities Act of 1933 during the period ended March 31, 1976.

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CERRO-MARMON CORPORATION

PRO FORMA CONDENSED CONSOLIDATED STATEMENT  
OF INCOME (NOTE A)

Three months ended March 31, 1976 and 1975

(In thousands of dollars)  
(Unaudited)

	<u>1976</u>	<u>1975</u>
Revenues:		
Net sales	\$295,176	\$241,600
Miscellaneous net	3,467	6,819
	<u>298,643</u>	<u>248,419</u>
Costs and expenses:		
Cost of product sold	259,072	206,067
Selling and administrative	16,252	17,620
Interest	<u>3,661</u>	<u>4,465</u>
	<u>278,985</u>	<u>228,152</u>
Income before income taxes	19,658	20,267
Income taxes	<u>9,692</u>	<u>9,899</u>
Net income	<u>\$ 9,966</u>	<u>\$ 10,368</u>

NOTES:

A. The above statement consists of:

1. The historical statements of The Marmon Group, Inc. (Michigan) and Cerro Corporation for the periods January 1, 1975 to March 31, 1975 and January 1, 1976 to February 24, 1976, adjusted on a pro forma basis to give effect to the adjustments resulting from the merger of Cerro into Cerro-Marmon (See Note 1 to the condensed consolidated financial statements) and the allocation of Cerro-Marmon's purchase cost to Cerro's net assets (See Note 3 to the condensed consolidated financial statements), as if the merger of Cerro had been completed at the beginning of each period, and
2. The historical financial statements of Cerro-Marmon Corporation for the period February 25, 1976 to March 31, 1976.

- B. The above statement should be read in conjunction with the condensed consolidated financial statements of Cerro-Marmon Corporation as of March 31, 1976 and for the three months then ended and related notes.

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# MANAGEMENT'S DISCUSSION AND ANALYSIS OF EARNINGS

The comparability of the accompanying condensed consolidated statement of income for the three months ended March 31, 1976 with the statement for the three months ended March 31, 1975 is significantly affected by the merger of Cerro Corporation into Cerro-Marmon Corporation on February 24, 1976 as discussed in the notes to the condensed financial statements. Therefore, the following comments relate to the accompanying pro forma condensed consolidated statements of income for the three months ended March 31, 1976 and March 31, 1975. Details of the pro forma net sales and income before income taxes are presented below, in thousands of dollars:

	<u>Three months ended March 31,</u>	
	<u>1976</u>	<u>1975</u>
Pro forma net sales:		
Manufacturing -		
Cerro operations	\$ 182,874	\$ 139,336
Marmon operations	<u>75,974</u>	<u>67,116</u>
Total	258,848	206,452
Mining	15,821	18,252
Trucking	<u>20,507</u>	<u>16,896</u>
Total	<u>\$ 295,176</u>	<u>\$ 241,600</u>
Pro forma income before income taxes:		
Manufacturing -		
Cerro operations	\$ 9,010	\$ 6,184
Marmon operations	<u>10,111</u>	<u>8,423</u>
Total	19,121	14,607
Mining	1,099	6,992
Trucking	996	794
Corporate administrative, interest and other expenses less miscellaneous revenues	<u>(1,558)</u>	<u>(2,126)</u>
Pro forma income before income taxes	<u>\$ 19,658</u>	<u>\$ 20,267</u>

## Manufacturing

### Cerro

Sales in the first quarter of 1976 were \$182,874,000 vs. \$139,336,000 for the like period in 1975. First quarter 1976 sales of metal products increased approximately 66% from the 1975 level

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which was impaired by strikes at two major plants. Sales of the metal trading operations increased approximately 25% due primarily to the liquidation of inventories maintained for the benefit of interest rate differentials rather than trading activities. Sales of wire and cable products declined approximately 10% from 1975 sales due to reduced demand in certain of their market segments.

Profits in the first quarter of 1976 were \$9,010,000 vs. \$6,184,000 for the like quarter of 1975. The increase is attributable to substantially improved results of the metal products operations from the strike depressed 1975 levels. These operations also benefited from more stable pricing and increased demand for many of their products and from increases in basic metal prices which resulted in higher profits on sales of inventories valued on a FIFO basis.

The metal trading operations also produced higher profits in 1976, primarily due to higher sales volume.

These profit improvements were partially offset by a significant decline in the profits of the wire and cable operations caused by severe price competition and reduced demand for their products.

#### Marmon

Sales increased in the first quarter of 1976 to \$75,974,000 from \$67,116,000 for the like quarter in 1975. Sales of each of Marmon's major businesses improved in 1976 except pipe and tubing which remained relatively flat. The major factor in the sales increase was the improved demand, particularly in the O.E.M. market, for Marmon's automotive products.

Profits for the first quarter of 1976 were \$10,111,000 as compared to \$8,423,000 for the same period in 1975. Increased sales of automotive products and mining equipment were the major reasons for the profit increase. Profits of the pipe and tubing operations continued to decline as a result of reduced margins.

#### Mining

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The decline in sales volume from \$18,252,000 in the first quarter of 1975 to \$15,821,000 in 1976 is primarily attributable to the reduced selling price of coal. Because of the acquisition of Stott Coal Co. and Jenner Mining after the first quarter of 1975, more tonnage was shipped in the comparable first quarter of 1976. However, the drastic reduction in the selling price of the various grades of coal sold by the Mining Group was the primary reason for the lowered sales volume. In addition, shipments under contract with the Japanese were reduced due to the economic conditions in Japan, and an agreement was reached whereby these shipments would be picked up in the latter part of 1976 or the beginning of 1977.

The greatly reduced selling price and the high fixed costs associated with coal mining drastically reduced the profits from \$6,992,000 in 1975 to \$1,099,000 for the comparable 1976 period.

Gross margins dropped from approximately 50% in 1975 to about 26% in 1976. It is expected that the selling price of coal will firm-up with the increasing steel production in both the U.S. and abroad and that commitments made under the Japanese contract will be honored by them through accelerated shipments throughout the balance of the year.

#### Trucking

Operating revenues increased by 21.4% in 1976 over 1975 (\$20,507,000 vs. \$16,896,000) due to the significantly depressed economic activity in 1975 and a 6% rate increase received after the first quarter of 1975. Particular strength was also noted in increased shipments in anticipation of the March 1976 strike, and in the Special Commodities (truckload shipments) section of the business.

Income of \$996,000 in 1976 compares to \$794,000 in 1975 and reflects comparable profit margins in 1976 to 1975 levels on increased 1976 revenues. Also, certain other costs were reduced in 1976.

#### Real estate (Leadership Housing, Inc.)

For reasons discussed in Note 2 of the consolidated financial statements, no amounts relating to the real estate operations are included in the accompanying pro forma consolidated statements of income. Leadership's sales continue to be relatively flat - \$7,661,000 for the first quarter of 1976 compared with \$7,165,000 for the first quarter of 1975.

Although there was a slight sales increase, a loss continues to be incurred based on Leadership's historical financial statements which do not reflect any purchase cost allocation adjustments resulting from the purchase of Cerro by Cerro-Marmon. Such loss before income taxes was approximately \$2,300,000 in the first quarter of 1976 compared with a loss of approximately \$2,600,000 in the first quarter of 1975. Losses are expected for the balance of the year. See Note 5 to the condensed consolidated financial statements for information relating to uncertainties as to Leadership.

#### Corporate administrative, interest and other expenses, less miscellaneous revenues

This net cost decreased from \$2,126,000 in 1975 to \$1,558,000 for the comparable period in 1976. The principal reasons are the reduction of home office personnel, the reduction in price interest rates along with the reduction in certain short and long-term debt obligations. The first quarter of 1975 also included a charitable donation of \$250,000. These reductions in expense were partially offset by reductions in miscellaneous revenues, primarily interest income from temporary investments of cash due to reduced amounts invested and lower interest rates.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CERRO-MARMON CORPORATION  
(Registrant)

DATE:

May 13, 1976

R. C. Gluth  
R. C. Gluth, Vice-President

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SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal  
Year Ended December 31, 1976 Commission File Number 1-7285

CERRO-MARMON CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 52-104-5483  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification Number)

39 South LaSalle Street, Chicago Illinois 60603  
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code (312) 372-9500

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
\$2.25 Cumulative Series A Preferred Stock	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No     

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of the period covered by this report.

5,000,000 shares of common stock were issued and outstanding at  
December 31, 1976.

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## PART I

### ITEM I - Business

Cerro-Marmon Corporation (Cerro-Marmon) was incorporated in Delaware on November 25, 1975 and was inactive until February 24, 1976. On that date, Cerro Corporation (Cerro) merged into Cerro-Marmon pursuant to a vote of shareholders duly taken on such date approving an Agreement and Plan of Merger and an Exchange Agreement each dated as of January 15, 1976. Pursuant thereto, GL Corporation (GL), a Delaware corporation, exchanged all the outstanding shares of capital stock of The Marmon Group, Inc. (Michigan) (Marmon), a Delaware corporation, for five million newly issued common shares of Cerro-Marmon, and Cerro then merged into Cerro-Marmon, with the outstanding common shares of Cerro held by persons other than Marmon being converted into and exchanged for an equal number of preferred shares of Cerro-Marmon. The Agreement and Plan of Merger and the Exchange Agreement are referred to as Exhibits 28 and 29 of this annual report.

Cerro-Marmon is primarily engaged in manufacturing operations; world-wide metals trading activities; coal mining; real estate operations; and a common carrier motor freight operation which is to be sold in June 1977. In addition, Cerro-Marmon has an equity interest in Southern Peru Copper Corporation, which is engaged in large copper mining operations in Peru.

A description of Cerro-Marmon's principal products, services, markets and sources of supplies follows:

#### MANUFACTURING

##### PIPE AND TUBING

Cerro-Marmon is engaged in the distribution of carbon, alloy and stainless steel pipe and tubing. Products are sold to a variety of customers, including manufacturers of machinery and capital goods, and to the refinery and petrochemical industries. The carbon, alloy and stainless steel pipe and tubing is purchased primarily from domestic steel mills. Competition is on the basis of service and price and, therefore, Cerro-Marmon maintains a wide variety of inventory, supplies technical assistance in conjunction with its sales activities and is required to fill orders promptly. There are eleven warehouses located in different areas of the United States. Numerous companies are engaged in the distribution of steel pipe and tubing; however, the sales by any one company do not account for any significant portion of total sales of this industry.

Cerro-Marmon also produces and sells copper plumbing tube, thin wall industrial copper tube, electrolytic copper cathode, small diameter drawn copper and extruded and drawn aluminum tubing and related items. These products are sold primarily to the general construction industry, the general appliance industry and manufacturers of automotive equipment. Plumbing tubing is sold principally to plumbing wholesalers direct from the mill. Copper and aluminum industrial tube is sold primarily to original equipment manufacturers through Cerro-Marmon's sales force and manufacturers representatives. Electrolytic copper cathodes are sold on the open market directly to the ultimate user and to Cerrosales (see Metals Trading).

Copper is purchased from foreign and U.S. producers and scrap dealers. Extruded aluminum ingots in billet form are purchased from prime aluminum producers in the United States and Canada.

There are approximately 24 primary and redraw copper tube companies with which Cerro-Marmon competes. All have capacity in excess of demand. Competition is on the basis of price and service with Cerro-Marmon maintaining regional warehouses and using its own sales force.

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## WIRE AND CABLE

Cerro-Marmon produces and sells single and multi-conductor building wire and cable, control, power and instrumentation cable, aerospace and marine cable, copper wire rod, electrical metallic tubing and co-axial cable. These products are sold through sales offices, manufacturers' representatives and distributors to the construction industry, public utilities and diversified manufacturers, including those in the defense, maritime and aerospace industries.

Wire and cable operations depend for raw materials, principally copper, on non-captive sources of supply, including purchases from United States, Canadian and other foreign producers of primary copper, from Cerrosales (see Metals Trading), from scrap dealers and customer generated scrap. Copper is purchased in the United States at U.S. producer prices, at dealer prices and at scrap prices.

There are a large number of competitors with which the wire and cable operations compete, no one of which necessarily produces the same product line. The competitive position, therefore, varies with each type of wire and cable produced. The wire and cable operations are not dependent on a single customer, or a small number of customers, the loss of which would have a materially adverse effect on this product line.

## METAL PRODUCTS

Cerro-Marmon produces and sells mill products, including brass and bronze rod, bar, shapes, wire, forgings, screw machine parts and die castings, as well as certain low melting point alloys, principally to original equipment manufacturers and metal distributors.

The principal markets are the housing, automotive, industrial process and control equipment, communication equipment and electrical equipment industries. In addition, a portion of the total sales are to distributors of brass rod products. There are seven major competitors producing substantially similar metal products as well as over 100 foreign and domestic companies competing in various lesser degrees with other metal products produced by Cerro-Marmon. Competition is on the basis of quality and geographic location of facilities.

Cerro-Marmon also manufactures and sells valves, fittings, regulators and control equipment for pressurized gasses, principally propane gas. Products are sold in the United States by a variety of methods, including both direct sales and sales through distributors and dealers. It is subject to intense competition from a large number of firms in the fields in which it is engaged.

## AUTOMOTIVE PRODUCTS

Truck flat leaf springs are manufactured for sale primarily to original equipment manufacturers (OEM), and secondarily to the replacement market.

In addition, Cerro-Marmon manufactures for sale, primarily to OEM's, gray iron castings for use in automotive parts such as brake and master brake cylinders, power steering pumps, etc. Compressors made with Cerro-Marmon castings are used in refrigeration and air conditioning systems. Malleable iron castings, also produced by Cerro-Marmon, are employed in the automotive, farm equipment, electrical and machine tool industries. A broad line of automotive parts is also manufactured, including automobile springs, automobile and truck transmission gears, shafts and synchronizers, clutch plates, U-bolts, chassis and related parts for sale primarily to the replacement market. Automotive products are manufactured to customer specifications and for inventory.

The principal raw materials used in automotive products are bar spring steel, steel forgings and steel plate. The manufacture of castings uses pigiron, scrap, coke, sand and limestone. Such materials are purchased from domestic and foreign sources.

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Truck flat leaf springs are manufactured through the use of steel stamping equipment, forming machines and heat treating facilities. Other automotive equipment is manufactured through using a broad spectrum of metal working equipment. Castings are produced through the use of equipment employing green sand and shell molding processes. Substantially all sales of OEM truck flat leaf springs are made to four of the major truck manufacturers.

Competition in this area is on the basis of price, quality and service. Although Cerro-Marmon believes itself to be an important factor in the medium and heavy duty truck flat leaf spring market, it is not an important factor in the other areas which comprise this product line.

#### MINING EQUIPMENT

Cerro-Marmon designs and manufactures underground mining equipment such as feeder-breakers, conveyors, roof bolters, a continuous mining system, mobile drills, haulages, winches, hoists, carbide drills, bits and augers, mine cars, brakeman cars and non-explosive blasting systems. These products are used principally in the coal mining industry and are sold in response to customer orders, primarily in the United States.

Steel used to manufacture mining equipment is purchased from domestic and foreign steel mills and service centers. Mining products are fabricated principally with medium and heavy duty fabricating, assembly and automatically controlled machining equipment. Gear reducers, electric motors, hydraulic and other components are purchased from various manufacturers.

Competition in the sale of underground mining equipment is on the basis of design, service and quality, as well as price. Cerro-Marmon believes that there are at least four companies having greater sales of such equipment, but that it is a significant factor in the market for conveyors and feeder breakers.

#### BUILDING PRODUCTS

This group designs and manufactures merchandising equipment for display and storage purposes, metal point-of-purchase displays and other similar products used principally by general merchandise, variety, department and discount stores, supermarkets and other self-service retail establishments. These products, which normally are designed and manufactured to the customer's specifications, are sold to a small group of customers, the five largest of which represented in excess of 80% of sales of this product line by Cerro-Marmon in 1976.

Raw materials used to make these products are cold-rolled steel and wood products. These products are fabricated through metal forming, punching, rolling, welding, machining, plating, sawing, boring, laminating and painting processes.

Competition in the area of store fixtures is on the basis of price, service and quality. This group participates in the design of the fixture and is able to offer the customer a product which meets his specific requirements. Numerous other companies manufacture store fixtures to specification, at least five of which may have greater market shares.

All-steel doors and door frames are sold nationally to distributors through salaried salesmen. Steel products are purchased from steel mills and steel service centers to make doors and door frames. Sales of steel doors are made to a large group of diverse customers none of which represents a significant portion of such sales.

This group competes with 80 metal door manufacturers on the basis of quality and price. There are four metal door manufacturers that may have greater market shares.

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## METALS TRADING

Cerro-Marmon is engaged in world-wide metal trading activities through its wholly-owned subsidiary Cerrosales. It trades, generally in a hedged position, in metal contracts on The Commodity Exchange, Inc. in New York, the London Metal Exchange and foreign exchange markets. Cerrosales deals in nonferrous refined metals, concentrates and ores, including copper, lead, zinc, silver and companion metals, and acts as exclusive copper sales agent in the United States and Canada for Corporacion del Cobre, Chile, an agency of the Government of Chile which oversees most copper production and sales operations of Chile.

## COAL MINING

Low volatile metallurgical coal is sold domestically and abroad with a substantial portion of the present production dedicated to a long-term Coal Sales Agreement (Agreement) with two Japanese corporations. The remaining production is sold to domestic and foreign steel producers through the spot market. Medium volatile metallurgical coal is sold principally to a major domestic steel producer.

The price of coal under the Agreement is subject to adjustments for certain cost fluctuations, quality requirements and ash and sulfur content. If shipments fail to meet such ash and sulfur specifications, the buyers may reject such shipments unless a reduced price is negotiated. In the event of a failure to successfully negotiate such price, the buyers may terminate the Agreement.

Expansions are underway which are expected to increase annual production of low volatile metallurgical coal from 1,050,000 short tons to 2,500,000 short tons at an estimated cost of \$30.6 million, of which approximately \$19.9 million had been expended as of December 31, 1976. The expansions are scheduled for completion in early 1978.

See Coal Mining Operations on pages 5 and 6 of this annual report for information on coal reserves.

Coal is transported primarily by rail. Within the coal industry, rail cars are in short supply from time to time. Their unavailability could have an adverse impact upon operations.

## REAL ESTATE

Cerro-Marmon's real estate operations are engaged in the sale of improved and unimproved land and the construction and sale of single-family housing. In addition, the real estate operations participate in joint ventures engaged in land development.

As a result of conditions of the real estate market in general, and in Florida in particular, Cerro-Marmon's wholly-owned subsidiary, Leadership Housing, Inc. (Leadership) has been experiencing operating losses. It is the intention of Cerro-Marmon's management to financially support Leadership and dispose of the remaining inventories in the ordinary course of business.

Effective April 1, 1976, Leadership transferred certain assets (located principally in California) and related debt to The Housing Group, Inc. (Housing Group), a newly formed wholly-owned subsidiary of Cerro-Marmon.

During 1976, GL formed The Communities Group, Inc. of Broward County (Communities) for the purpose of purchasing land from Leadership. As of December 31, 1976, Leadership had sold to Communities, at book value, approximately \$2,243,000 of land subject to existing indebtedness.

As a result of the transfer of construction activities to Housing Group and Communities, all operating and administrative personnel employed by Leadership became employees of Housing Group and Communities at January 1, 1977.

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## SOUTHERN PERU COPPER CORPORATION (SPCC)

Cerro-Marmon has a 21% interest in SPCC, which holds concessions over two mines, Toquepala and Cuajone, in Peru. The Toquepala mine has reserves of 225 million tons of sulfide ore. The Cuajone mine has an estimated 470 million tons of sulfide ore reserves, 13.8 million tons of oxide material reserves and 108 million tons of leach material reserves.

### TRUCKING

Illinois-California Express, Inc., a Nebraska trucking corporation (ICX), is a Class I common carrier of general commodities subject to regulation by the Interstate Commerce Commission.

Cerro-Marmon expects to sell its trucking subsidiary to ICX Corporation, a newly created corporation formed by certain employees of the trucking concern, in June 1977. Pursuant thereto Cerro-Marmon expects to acquire a 19.8% minority interest in ICX Corporation and realize a gain on the sale.

### EMPLOYEES

At December 31, 1976 Cerro-Marmon employed approximately 11,000 persons.

### ENVIRONMENTAL MATTERS

Cerro-Marmon is subject to various federal, state and local laws, ordinances and regulations relating to plant safety and air and water pollution. Cerro-Marmon has not received any material citations for violations of such laws, ordinances or regulations. Cerro-Marmon believes that it is presently in substantial compliance with all such laws, ordinances and regulations and does not anticipate making major capital expenditures in connection with environmental matters. Because of the continued development of new regulations and reinterpretation of existing regulations in this area, Cerro-Marmon is unable to predict the effect, if any, which any such regulation may have on its business in the future.

### INFORMATION AS TO LINES OF BUSINESS

Information with respect to the principal lines of business appears on pages 34 and 36 of Cerro-Marmon's 1976 annual report to shareholders and is hereby incorporated by reference.

#### ITEM 2 - Summary of Operations

The summary of operations for the five years ended December 31, 1976 and the pro forma statement of income for the two years ended December 31, 1976 and Management's Discussion and Analysis of Results of Operations appear on pages 33, 35, 38 and 39 of Cerro-Marmon's 1976 annual report to shareholders and are hereby incorporated by reference.

#### ITEM 3 - Properties

### MANUFACTURING OPERATIONS

Cerro-Marmon's manufacturing operations are conducted at 45 principal locations having an aggregate of approximately 7 million square feet of floor space. All significant manufacturing facilities are owned and, in the opinion of management, well maintained and suitable for their intended use.

### COAL MINING OPERATIONS

Cerro-Marmon owns and leases operating properties in Somerset County, Pennsylvania

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containing coal reserves, principally of metallurgical quality. Properties, covering approximately 15,000 acres, contain reserves of approximately 53 million short tons of clean recoverable low and medium volatile metallurgical coal. In addition, Cerro-Marmon owns or leases parcels of land containing coal deposits for which there are no comprehensive exploratory studies. Cerro-Marmon, therefore, is unable to determine the amount of coal in such parcels which will be mined.

#### REAL ESTATE OPERATIONS

The major landholdings of Leadership, other than those presently under development with the joint ventures, are: 600 acres in Broward County, Florida; 3,800 acres in Pinellas and Hillsborough Counties, Florida; 800 acres in Palm Beach County, Florida; and 102 acres on Kauai, Hawaii.

#### ITEM 4 - Parents and Subsidiaries

GL owns five million common shares of Cerro-Marmon, which represents all of the issued and outstanding common stock of Cerro-Marmon and 82% of the voting interest in Cerro-Marmon.

Following is a list of all significant subsidiaries of Cerro-Marmon, indicating the percentage of voting securities owned by Cerro-Marmon and the state or foreign country of incorporation of each:

<u>Name of Subsidiary*</u>	<u>Percentage Of Voting Securities Owned</u>	<u>State or Foreign Country of Incorporation</u>
The Marmon Group, Inc. (Michigan)	100	Delaware
Amarillo Gear Company ***	100	Delaware
Pikrose and Company, Ltd.	100	England
Keystone Tubular Service Corporation	100	Delaware
Penn Brass and Copper Company ***	100	Pennsylvania
Triangle Auto Spring Company of Delaware ***	100	Delaware
Perfection American Company ***	100	Delaware
The Marmon Group of Canada, Inc.	100	Canada
The Boykin Company	100	Delaware
Marmon Services Co. ***	100	Delaware
Cerro Sales Corporation	100	Delaware
Cerro Metals (U.K.) Limited	100	England
Cerro International S.A.	100	Belgium
Fetterolf Coal and Construction, Inc.	100	Delaware
M.F. Fetterolf Coal Co., Inc.	100	Delaware
M.F. Land Company, Inc.	100	Pennsylvania
Jenner Mining Corporation	100	Pennsylvania
GM&W Coal Company, Inc.	100	Pennsylvania
JMS Mining Corporation	100	Pennsylvania
James M. Stott Coal Company	100	Pennsylvania
Stott Coal Company	100	Pennsylvania
Golconda Corporation	85	Idaho
ICX Industries, Inc. ****	100	Delaware
Illinois-California Express, Inc.	94	Nebraska
Leadership Housing, Inc. **	100	Delaware

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The Housing Group, Inc.	100	Delaware
Tamarac Utilities, Inc.	100	Florida

In addition, Cerro-Marmon has a number of other subsidiaries which, considered in the aggregate, would not constitute a significant subsidiary.

- \* Included in the consolidated financial statements, except for ICX, Leadership and Housing Group which are accounted for on the equity method.
- \*\* Leadership has 16 subsidiaries engaged in real estate and related activities.
- \*\*\* Effective January 1, 1977 these corporations were liquidated into The Marmon Group, Inc. (Michigan).
- \*\*\*\* To be sold in June, 1977.

#### ITEM 5 - Legal Proceedings

A discussion of pending legal proceedings appears on pages 28 through 31 of Cerro-Marmon's 1976 annual report to shareholders which is hereby incorporated by reference. See also "Environmental Matters" under Item 1 - Business.

#### ITEM 6 - Increases and Decreases in Outstanding Securities

(a) Cerro-Marmon was incorporated in Delaware on November 25, 1975 and was inactive until February 24, 1976. The authorized capital stock of Cerro-Marmon at February 24, 1976 consisted of the following:

##### Common -

10,000,000 shares of \$1 par value. 5,000,000 shares are outstanding, all issued and all owned by GL. Such securities were not registered under the Securities Act of 1933, in reliance upon an exemption from registration provided by Section 4(3) of that Act.

##### Preferred -

10,000,000 shares of \$1 par value preferred stock designated \$2.25 Cumulative Series A Preferred Stock - issued as follows:

Shares issuable at February 24, 1976	4,324,970
Less - Shares surrendered for cash at \$19 per share at various dates	1,668
Shares in dissent seeking appraisal rights	<u>64,245</u>
Shares issued and outstanding at December 31, 1976 (including 141,769 shares held in trust for unlocated shareholders)	<u><u>4,259,057</u></u>

See Note 17 of Notes to Consolidated Financial Statements contained in Cerro-Marmon's 1976 annual report to shareholders which is hereby incorporated by reference.

(b) Increase (decrease) in the amount of outstanding debt securities and indebtedness.

#### 12% Subordinated Promissory Notes to an Individual

Reference is made to Cerro-Marmon's Form 8-K for the month of July 1976.

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## ITEM 7 Approximate Number of Equity Security Holders

<u>Title of Class</u>	<u>Number of Holders Of Record at December 31, 1976</u>
Cerro-Marmon Corporation Common Stock	1
Cerro-Marmon Corporation \$2.25 Cumulative Series A Preferred Stock	14,556*

\*Represents actual number of shareholders who through December 31, 1976 have converted Cerro Common shares into Cerro-Marmon Preferred shares.

## ITEM 8 - Executive Officers of Cerro-Marmon

(a) Listed below are the names and ages of all executive officers of Cerro-Marmon and the positions and offices held by each:

Jay A. Pritzker	Chairman of the Board	54
Robert A. Pritzker	President	50
Robert C. Gluth	Executive Vice President	52
George A. Jones	Executive Vice President	56
Frederick J. Manning	Treasurer	29
Thomas L. Seifert	Secretary & Legal Counsel	36
John Spevacek	Controller	49

Messrs. Jay A. Pritzker and Robert A. Pritzker are brothers. There are no other family relationships among the executive officers of Cerro-Marmon.

(b) Business experience of each executive officer during the past five years:

### JAY A. PRITZKER

Mr. Pritzker was elected Chairman of the Board of Cerro-Marmon in January 1976. He became a director of Cerro in March 1974 and Chairman of the Board of Cerro in February 1975. He is presently Chairman of the Board of Marmon (since 1963) as well as an attorney and member of the law firm of Pritzker and Pritzker.

### ROBERT A. PRITZKER

Mr. Pritzker was elected a Director of Cerro-Marmon in November 1975 and its President in February 1976. He became a Director of Cerro in December 1974 and its President in February 1975. He is the President and a Director of Marmon, which positions have been held for more than five years.

### ROBERT C. GLUTH

Mr. Gluth was elected Executive Vice President of Cerro-Marmon in September 1976. He was elected a Director of Cerro-Marmon in November 1975 and Vice President of Cerro-Marmon in February 1976. He was elected a Vice President of Cerro in May 1975 and a Director in June 1975. He has been a Vice President of Marmon since February 1970.

### GEORGE A. JONES

Mr. Jones was elected Executive Vice President of Cerro-Marmon in September 1976. He

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became a Vice President and Director in February 1976. He was elected a Director of Cerro in June 1975. Mr. Jones was a Vice President of Marmon from 1970 to 1972 and an Executive Vice President and Director of Marmon since 1972.

#### FREDERICK J. MANNING

Mr. Manning was elected Treasurer of Cerro-Marmon in April 1976. He held the position in Marmon (since 1971) as Manager of Insurance and Employee Benefits, was elected Assistant Treasurer of Marmon in April 1973 and Treasurer in October 1975.

#### THOMAS L. SEIFERT

Mr. Seifert was elected Secretary and Legal Counsel of Cerro-Marmon in January 1976. He has been Secretary and General Counsel of Golconda Corporation since December 1975. He became Associate General Counsel and Assistant Secretary of Cerro in October 1975. Prior to joining Cerro, Mr. Seifert was Associate General Counsel for Canteen Corporation (April 1973 to October 1975) and an attorney with Standard Oil Company (Indiana) (December 1970 to April 1973).

#### JOHN SPEVACEK

Mr. Spevacek was elected Controller of Cerro-Marmon in September 1976. He was formerly Vice President and Controller of Cerro since June 1975. Prior to joining Cerro, Mr. Spevacek was President and Chief Executive Officer of Anderson Manufacturing Company, Inc. (September 1973 to June 1975). From May 1967 to September 1973, Mr. Spevacek served as Group Vice President - Finance of Amphenol Components Group, Bunker Ramo Corporation.

#### ITEM 9 - Indemnification of Directors and Officers

The General Corporation Law of the State of Delaware provides authority for the indemnification of directors and officers in the defense of civil and criminal actions and the purchase of insurance in connection therewith. The Bylaws of Cerro-Marmon provide for the indemnification of directors and officers to the full extent and in the manner permitted by the laws of the State of Delaware. Cerro-Marmon does not have insurance covering its directors and officers.

#### ITEM 10 - Financial Statements and Exhibits

Listed below are all of the financial statements and exhibits filed as part of this report:

(a) Financial Statements - see pages 15 and 16.

(b) Exhibits:

1. Certified copy of Certificate of Incorporation of Cerro-Marmon Corporation, dated November 25, 1975 as filed with Secretary of State of the State of Delaware.
2. Certified copy of Certificate of Designation, Powers, Preferences and Rights of the Series of the Preferred Stock of Cerro-Marmon Corporation, dated February 17, 1976 as filed with the Secretary of State of the State of Delaware.
3. Certified copy of Certificate of Incorporation of Cerro-Marmon and Certificate of Amendment of Certificate of Incorporation of Cerro-Marmon dated February 17, 1976 as filed with the Secretary of State of the State of Delaware.
4. By-Laws of Cerro-Marmon Corporation as approved by the Board of Directors at the February 24, 1976 Meeting amended as of May 24, 1976.

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5. Certified copy of Certificate of Merger of Cerro Corporation and Cerro-Marmon Corporation, dated February 24, 1976 as filed with the Secretary of State of the State of New York.
6. Registration Statement on Form S-14 as filed by Cerro-Marmon Corporation with the SEC on January 26, 1976.
7. SEC Order declaring the Registration Statement Form S-14 effective at 1:00 P.M. E.S.T. on January 26, 1976.
8. Registration Statement on Form 8-A as filed by Cerro-Marmon Corporation with the SEC on February 12, 1976.
9. Amendment No. 1 to Registration Statement on Form 8-A dated February 9, 1976, as filed with the SEC on February 24, 1976.
10. Amendment No. 2 to Registration Statement on Form 8-A dated February 9, 1976, as filed with the SEC on February 25, 1976.
11. Schedule 13-D of The Marmon Group, Inc. (Michigan) filed pursuant to Rule 13d-2, dated September 27, 1974.
12. Amendment No. 1 to Schedule 13D of The Marmon Group, Inc. (Michigan) filed pursuant to Rule 13d-2, dated December 16, 1975.
13. Amendment No. 2 to Schedule 13D of The Marmon Group, Inc. (Michigan) filed pursuant to Rule 13d-2, dated March 1, 1976.
14. Listing Application of Cerro-Marmon Corporation for \$2.25 Cumulative Series A Preferred Stock, dated February 24, 1976.
15. Listing Eligibility Opinion of American Stock Exchange dated February 18, 1976.
16. Letter from Cerro-Marmon Corporation to the American Stock Exchange regarding Tax Sharing Agreements, dated February 23, 1976.
17. Letter from Cerro-Marmon Corporation to the American Stock Exchange regarding compliance with Exchange regulations, dated February 24, 1976.
18. The Internal Revenue Service tax ruling dated January 30, 1976.
19. The Internal Revenue Service supplemental tax ruling dated April 9, 1976 with attached memo dated April 17, 1976.
20. Tax Sharing Agreement among GL Corporation, The Marmon Group, Inc. (Michigan) and certain of their subsidiaries, dated December 31, 1971.
21. Supplemental Tax Sharing Agreement among GL Corporation, The Marmon Group, Inc. (Michigan) and certain of their subsidiaries, dated December 31, 1971.
22. Adoption Agreement among certain subsidiaries of GL Corporation, dated December 31, 1972.
23. Adoption Agreement among certain subsidiaries of GL Corporation, dated December 31, 1973.

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24. Adoption Agreement among certain subsidiaries of GL Corporation, dated December 31, 1974.
25. Interest Agreement dated January 1, 1975 among parties to the 1971 Tax Sharing Agreement and its Supplemental Agreement, both dated December 31, 1971.
26. Amendment and Restatement of the Supplemental GL Tax Sharing Agreement, dated as of February 24, 1976.
27. Tax Allocation Agreement between Behring Corporation and Cerro Corporation, dated July 31, 1972.
28. Agreement and Plan of Merger dated as of January 15, 1976 by and between Cerro-Marmon Corporation and Cerro Corporation. (Incorporated by reference to Form S-14 Registration Statement as filed with the Securities and Exchange Commission on January 26, 1976.)
29. Exchange Agreement dated as of January 15, 1976 among GL Corporation, The Marmon Group, Inc. (Michigan), Cerro Corporation and Cerro-Marmon Corporation. (Incorporated by reference to Form S-14 Registration Statement as filed with the Securities and Exchange Commission on January 26, 1976).
30. Cerro Corporation Prospectus and Proxy Statement dated January 26, 1976. (Incorporated by reference to Form S-14 Registration Statement as filed with the Securities and Exchange Commission on January 26, 1976).
31. Note Agreement of February 6, 1967 among Cerro Corporation, The Prudential Insurance Company of America and Aetna Life Insurance Company, as amended. (Incorporated by reference to Form 8-K of Cerro Corporation for March 1967 and Forms 10-K of Cerro Corporation for the years ending December 31, 1967 through 1974).
32. Letters dated December 31, 1975 from The Prudential Insurance Company of America and Aetna Life Insurance Company to Cerro amending Exhibit 31. (Incorporated by reference to Form S-14 Registration Statement as filed with the Securities and Exchange Commission on January 26, 1976).
33. Letter of March 31, 1975 from The Prudential Insurance Company of America to Cerro amending Exhibit 31.
34. Letter of May 6, 1975 from Aetna Life Insurance Company to Cerro amending Exhibit 31.
35. Amended and Restated Loan Agreement dated as of June 30, 1975 between Leadership Housing, Inc. and certain institutional lenders. (Incorporated by reference to Form 8-K of Cerro Corporation for the month of June, 1975).
36. March 9, 1976 Amendment to Exhibit 35. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1975).
37. Collateral Agreement between Cerro Corporation and First National City Bank dated June 18, 1975 relating to Exhibit 35. (Incorporated by reference to Form 8-K of Cerro Corporation for the month of June, 1975).
38. Participation Agreement between Cerro Corporation and First National City Bank dated June 18, 1975 relating to Exhibit 35. (Incorporated by reference to Form 8-K of Cerro Corporation for the month of June, 1975).

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39. Subordination Agreement between Cerro Corporation and First National City Bank dated June 18, 1975 relating to Exhibit 35. (Incorporated by reference to Form 8-K of Cerro Corporation for the month of June, 1975).
40. 1976 Profit Sharing Plan for ICX Industries, Inc. (Incorporated by reference to Form S-14 Registration Statement as filed with the Securities and Exchange Commission on January 26, 1976).
41. Loan Agreement among Fetterolf Coal And Construction, Inc., Sumitomo Metal Industries, Limited and Mitsubishi Corporation dated October 1, 1974 and amendment thereto dated as of December 16, 1974. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
42. Coal Sales Agreement dated October 1, 1975 among Fetterolf Coal And Construction, Inc., Sumitomo Metal Industries, Limited and Mitsubishi Corporation and addendum thereto. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
43. Letter of October 1, 1974 from Cerro to Mitsubishi Corporation and Sumitomo Metal Industries, Limited relating to Exhibits 41 and 42. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
44. Operating Agreement of March 11, 1975 by and among Fetterolf Coal And Construction, Inc. and Mitsubishi Corporation and Sumitomo Metal Industries, Limited. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
45. Agreement between Cerro and C. Gordon Murphy dated June 12, 1974. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
46. Amendment dated December 16, 1974 to Exhibit 45. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
47. Agreement between Cerro and C. Gordon Murphy and letters relating thereto dated February 12, 1975. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
48. Agreement between Cerro and C. Gordon Murphy and letters relating thereto dated February 12, 1975. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
49. General Indemnity Agreement of May, 1971 between Cerro and Argonaut Insurance Company. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
50. General Indemnity Agreement between Cerro and Highland Insurance Company. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
51. Amendment dated February 12, 1975 to Agreement of May 30, 1972 between Leadership Housing, Inc. and Harrison M. Lasky. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).
52. Amendment of March 14, 1975 of the Joint Venture Agreement of Leadership Housing, Inc. dated December 20, 1972. (Incorporated by reference to Form 10-K of Cerro Corporation for the year ending December 31, 1974).

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A copy of any exhibit may be obtained by a stockholder of Cerro-Marmon by making a written request therefore to the Secretary of Cerro-Marmon and by paying Cerro-Marmon's costs of reproduction and postage.

ITEMS 11 through 15, inclusive

Information called for by Items 11 through 15, inclusive, will not be filed at this time pursuant to General Instruction H which permits omission if a definitive proxy statement is filed not later than 120 days after the close of the year.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CERRO-MARMON CORPORATION  
(Registrant)

BY: 

(Signature)  
Robert C. Gluth  
Executive Vice President  
CERRO-MARMON CORPORATION

BY: 

(Signature)  
Thomas L. Seffer  
Secretary and Legal Counsel  
CERRO-MARMON CORPORATION

April 25, 1977

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CERRO-MARMON CORPORATION

INDEX TO FINANCIAL STATEMENTS  
COVERED BY REPORTS OF CERTIFIED PUBLIC ACCOUNTANTS  
(Item 10(a))

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References	
Form 10-K (Page)	Annual Report to Shareholders (Page)

Boca del Mar Associates and Boca del Mar Golf and  
Tennis Clubs (Partnerships):  
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All other schedules for Cerro-Marmon Corporation and Leadership Housing, Inc. have been omitted since the required information is not present or is not present in amounts sufficient to require submission of the schedule or because the information required is included in the respective financial statements or the notes thereto.

Financial statements of the nonconsolidated subsidiaries, other than the financial statements of Leadership Housing, Inc., and the affiliated companies have been omitted since, in the aggregate, these companies do not constitute a "significant subsidiary".

Those financial statements listed in the above index together with the report thereon of Arthur Young & Company dated April 22, 1977 which are included in the annual report to shareholders of Cerro-Marmon Corporation for the year ended December 31, 1976 are hereby incorporated by reference. All other pages of Cerro-Marmon's annual report to shareholders are incorporated elsewhere herein by reference, with the exception of the Letter from Chairman and President and General Information on pages 1, 2 and 3 which are not deemed to be filed as part of this annual report.

Financial statements of Cerro-Marmon (not consolidated) have been omitted for the year ended December 31, 1975 since Cerro-Marmon was at that time an inactive company (Note 1 of Notes to Consolidated Financial Statements). Financial statements of Cerro-Marmon (not consolidated) for the year ended December 31, 1976 have been omitted and will be subsequently filed by amendment to this annual report.

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CONSENT OF CERTIFIED PUBLIC ACCOUNTANTS

We consent to the incorporation by reference in this Annual Report on Form 10-K of Cerro-Marmon Corporation of our report dated April 22, 1977 included in the 1976 annual report to shareholders of Cerro-Marmon Corporation.

We also consent to the addition of the supplementary information and consolidated schedules of Cerro-Marmon Corporation listed in the accompanying index to financial statements to the statements covered by our report dated April 22, 1977 incorporated herein by reference.

ARTHUR YOUNG & COMPANY

Chicago, Illinois  
April 22, 1977

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors  
of ICX Industries, Inc.

In our opinion, the consolidated balance sheet and the related consolidated statements of earnings, of changes in stockholders' equity and of changes in financial position of ICX Industries, Inc. (not presented separately herewith) present fairly the financial position of ICX Industries, Inc. and its subsidiary at December 31, 1976, and the results of their operations and the changes in their financial position for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

*Price Waterhouse & Co.*

PRICE WATERHOUSE & CO.

2300 Colorado National Building  
Denver, Colorado 80202  
February 3, 1977, except as  
to the fourth paragraph of Note  
8 which is set forth below,  
which is as of February 23, 1977

NOTE 8 - (fourth paragraph):

Under the terms of the two bank agreements signed February 23, 1977, ICX INCORPORATED and ICX have obtained revolving credits for \$25,000,000, subject to certain conditions for closing and certain borrowing limitations. Any loans under these agreements will be secured by a pledge of ICX's capital stock, revenue equipment and certain other operating equipment and terminal properties, and operating rights and authorities. The agreements contain various restrictive covenants including current ratio, net worth, cash dividends, redemption of capital stock and limits on additional indebtedness.

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## CERRO-MARMON CORPORATION

### SUPPLEMENTARY INFORMATION

#### Inventories and Cost of Goods Sold

Inventories and supplies at December 31, 1974 used to determine cost of goods sold were \$55,098,000.

For purposes of determining the lower of cost or market for coal and manufacturing inventories, market is generally considered to be net realizable value. Cost consists principally of raw materials and purchased components, direct labor and direct and indirect manufacturing or mining costs.

#### Stock Options

In connection with the merger of Cerro into Cerro-Marmon, Cerro's obligations with respect to two stock option plans covering key employees were assumed by Cerro-Marmon. As a result, all outstanding options were converted from options on Cerro common stock into options on Cerro-Marmon preferred stock. The 1970 Plan, under which no additional options may be granted, is a qualified plan whereas the 1971 Plan is a non-qualified plan. Options granted under the Plans generally expire five years from the date of grant.

Options under the 1970 Plan entitle an optionee to receive shares of Cerro-Marmon's preferred stock, whereas options under the 1971 Plan entitle an optionee to receive cash in an amount equal to the difference between the option price and the market value of Cerro-Marmon's preferred stock at the time the option is exercised. The exercise of an option under the 1971 Plan by an optionee holding an option under the 1970 Plan results in cancellation of the 1970 Plan option.

The 1971 Plan provides that the option price per share is subject to reduction in an amount equal to the aggregate cash dividends declared and paid on each share during the period beginning with the later of (a) May 14, 1974 or (b) the date of grant of the option and ending on the date the option is presented for exercise, subject to the limitation that in no event will the option price per share be reduced to less than 50% of the original option price per share. The 1971 Plan is to remain in effect until terminated by the Board, but no options may be granted after February 23, 1980.

The Board of Directors has the power to cancel all or any part of any outstanding options under the 1971 Plan in the event it determines that the ultimate federal income tax consequences or the financial accounting effects of the exercise of options under the plan would not be in the best interest of Cerro-Marmon.

The option price under both Plans is 100% of fair market value of the stock on the date of grant. Details of transactions for the period subsequent to February 24, 1976, the date of merger of Cerro into Cerro-Marmon, through December 31, 1976 were as follows:

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	No. of Shares	Option Price (Note)		Market Value	
		Per Share	Amount	Per Share	Amount
Options exercisable at February 24, 1976				At February 24, 1976	
1970 Plan	24,859	\$13.88 to 17.25	\$ 406,897	\$ 19.00	\$ 472,321
1971 Plan	81,690	8.72 to 15.16	952,414	19.00	1,552,110
Options exercised				At Dates Exercised	
1971 Plan	29,700	11.41 to 15.16	420,664	19.88 to 21.88	606,113
Options cancelled					
1970 Plan	21,066	15.13 to 17.25	349,263		
1971 Plan	9,000	11.41 to 15.16	117,629		
Options outstanding December 31, 1976				At December 31, 1976	
1970 Plan	3,793	13.88 to 16.19	57,634	23.25	88,187
1971 Plan	42,990	8.72 to 14.19	414,122	23.25	999,518

NOTE: Option price per share under the 1971 Plan has been adjusted to reflect cash dividends declared and paid on and after May 14, 1974 as discussed above.

The expected cost to Cerro-Marmon of assuming Cerro's option obligations was accrued as to the 54.67% interest in Cerro acquired by Cerro-Marmon as of February 24, 1976 in connection with the allocation of purchase cost to Cerro's net assets. Increases in the excess of the market value of the preferred stock subject to outstanding options over the related option prices are accounted for by charges to expense as such increases occur.

#### Plant and Equipment

Depreciation rates used were as follows:

Buildings and improvements (Note)	2% to 20%
Machinery and equipment	4% to 50%
Utility plant	2.5% to 10%

NOTE:

Leasehold improvements are depreciated over the lesser of the term of the lease or the useful life of the asset.

#### Current Replacement Cost Information (Unaudited)

The following current replacement cost information is presented pursuant to the requirements of the Securities and Exchange Commission (SEC). Some of the factors to be considered in interpreting this information are as follows:

The determination of estimated replacement cost requires subjective judgments and estimates. Because of such subjective judgments and the errors inherent in estimates, the data may not be fully comparable between companies providing such data.

Simplistic use of the replacement cost information should be avoided. The SEC intentionally determined not to require the disclosure of the effect on net income of calculating cost of sales and depreciation on a current replacement cost basis, both because there are substantial theoretical problems in determining an income effect and because it did not believe that users should be encouraged to convert the data into a single revised net income figure. The factors of subjective judgment, errors inherent in estimation and the

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many specific factual circumstances involved make the data inappropriate to the determination of "true income" or comparability between companies.

The replacement cost information is based upon the hypothetical assumption that replacement of inventory and productive capacity would be on an "instant" basis. The replacement cost estimates do not take into account the manifold problems resulting from such hypothetical change and accordingly would require studies in depth before undertaking actual replacement. The estimates are not necessarily indicative of management's intentions with respect to replacement or of costs that might be incurred; nor should the information be interpreted as to indicate that present plans to replace productive capacity or actual replacement would or could take place in the manner assumed in estimating the information.

Replacement cost data is not necessarily indicative of current value or sales value; nor does it represent adjusted book value.

The information does not reflect all the effects of inflation and other economic factors on Cerro-Marmon's current cost of operations; nor does it reflect consideration of these effects on assets other than inventories and productive capacity and the related effects on other costs.

It must also be recognized that comparison between Cerro-Marmon's historic cost and replacement cost information requires consideration of the adjustments to Cerro's historic costs arising out of the purchase of Cerro by Cerro-Marmon. The purchase cost allocation required as a result of this purchase had the effect of completely eliminating the carrying value of property, plant and equipment at August 1, 1974, and subsequent depreciation thereon, with respect to Cerro-Marmon's 45.33% purchase of Cerro and significantly reducing such carrying value at February 24, 1976, and subsequent depreciation thereon, with respect to Cerro-Marmon's 54.67% purchase of Cerro. Accordingly, accumulated depreciation on a Cerro-Marmon historical cost basis includes depreciation on Cerro's plant and equipment additions subsequent to August 1, 1974 with respect to the 45.33% purchase and ten months' depreciation with respect to the 54.67% purchase.

The estimated replacement cost of a substantial portion of Cerro-Marmon's property, plant and equipment relates to property acquired in used condition, largely as a result of Cerro-Marmon's purchase of Cerro. The useful lives assigned to such properties were necessarily shorter than would have been assigned to comparable new assets. However, for purposes of calculating depreciation on used properties on a current replacement cost basis, Cerro-Marmon's policy with respect to the useful lives of new properties has been reflected. Additionally, for purposes of calculating accumulated depreciation on used properties on a current replacement cost basis, expired lives have been determined by subtracting estimated remaining lives from new property lives.

Cerro-Marmon computes depreciation on property, plant and equipment principally on accelerated methods. Pursuant to SEC requirements, depreciation on a replacement cost basis is computed on a straight line basis. Additionally, improvements to existing properties have significantly extended the originally assigned useful lives of such properties in some instances. These factors further complicate interpretation of the accompanying information.

In recognition of the unique problems involved in the determination of replacement cost of mineral reserve assets, the SEC has granted a one-year exemption from the determination of such information. Accordingly, the replacement cost of inventories and cost of sales includes depletion of Cerro-Marmon's coal reserves on a historic cost basis.

This information is provided as required, but in the opinion of management has very limited analytic value. Any analysis must consider the limitations noted above and the methods of estimation described below.

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	Historic Cost (In thousands)	Estimated Replacement Cost (in thousands of dollars)
December 31, 1976:		
Inventories	<u>\$ 202,120</u>	<u>\$ 234,020</u>
Property:		
Buildings and improvements	\$ 37,834	\$ 147,471
Machinery and equipment (including processing plants for coal and utility operations)	<u>70,356</u>	<u>338,370</u>
	108,190	485,841
Less accumulated depreciation	<u>31,629</u>	<u>215,789</u>
	76,561	<u>\$ 270,052</u>
Land, including mineral reserve assets net of accumulated depletion of \$512	<u>23,531</u>	
Property - net	<u>\$ 100,092</u>	
Year ended December 31, 1976:		
Cost of sales (including \$8,720 historic cost depreciation and \$22,692 replacement cost depreciation)	<u>\$ 703,515</u>	<u>\$ 717,828</u>
Depreciation expense (exclusive of amounts allocated to cost of sales)	<u>\$ 740</u>	<u>\$ 1,132</u>

The methods of estimation of replacement costs were as follows:

**Buildings and improvements** - Current estimated construction costs to obtain equivalent space within acceptable geographical locations. Such current estimated construction costs were obtained from vendors or available appraisal reports or were obtained through application of "unit of space" costing techniques.

**Machinery and equipment** - Vendor quotations on the major items of equipment, use of engineering estimates and the use of productive capacity cost per unit in the case of the coal processing and utility plants. The replacement cost of the remaining property was estimated based upon the relationship of replacement cost to historic cost developed as described above.

**Inventories** - Raw materials: current prices or quotations reflecting the terms and conditions under which Cerro-Marmon generally purchases its materials. Work in process and finished goods: current raw material costs plus estimated labor and overhead costs, including depreciation on a replacement cost basis, which would be incurred in replacement of inventory based upon current cost experience and production volumes.

**Cost of sales** - Adjustment of historic cost of sales for the replacement cost effect on opening and closing inventory, replacement cost of materials that were significantly different in price throughout the year and replacement cost depreciation. With respect to metal trading inventories and inventories valued under the LIFO method (31% and 22% of consolidated ending inventories, respectively), cost of sales on a historic cost basis was generally determined to closely approximate cost of sales on a replacement cost basis.

Cerro-Marmon is generally not subject to unusually rapid technological change in its manufacturing processes. Nonetheless, it is important to note that the above replacement cost data generally contemplates a continuation of manufacturing techniques and processes presently employed by Cerro-Marmon. Prior to actual replacement, different manufacturing techniques and

processes would be subjected to extensive review and evaluation and might significantly impact the replacement cost data stated above.

The replacement cost data presented above does not reflect operating cost savings which might result from the replacement of existing productive capacity. If Cerro-Marmon's productive capacity were to be replaced in the manner assumed in the determination of replacement cost, many costs other than depreciation (e.g. direct labor costs, repairs and maintenance and other indirect costs) would be altered.

Supplementary Income Statement Information

Supplementary income statement information is as follows:

	Year Ended December 31,	
	1976	1975
	(In thousands of dollars)	
Maintenance and repairs	\$ 17,196	\$ 4,184
Taxes other than income taxes	13,940	4,427
Interest expense:		
Long-term obligations	10,236	7,095
Other interest	1,106	929

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SCHEDULE III

CERRO-MARMON CORPORATION

SCHEDULE III - INVESTMENT IN, EQUITY IN EARNINGS OF, AND  
DIVIDENDS RECEIVED FROM AFFILIATED AND OTHER PERSONS  
(In thousands of dollars)

Column A	Column B	Column C	Column D	Column E	Column F
Name of issuer and description of investment	Balance at beginning of period Number of shares of dollars	Additions Equity in net earnings Other	Distribution of earnings Other	Balance at end of period Number of shares Amount in dollars	Dividends received during the period from investments not accounted for by the equity method
<b>Year ended December 31, 1975:</b>					
Cerro Corporation	3,586,297	\$ 70,165		3,586,297	\$ 78,896
Other persons not accounted for by the equity method	Various			Various	\$ 68
<b>Year ended December 31, 1976:</b>					
Cerro Corporation	3,586,297	\$ 78,896		3,586,297	\$ 78,896
Real estate subsidiaries					
Trucking subsidiary		\$ 542(1)	\$ 653(2)	Various	\$ 542(3)
Other persons not accounted for by the equity method	Various	\$ 3,219	\$ 654(2)	2,180,000	\$ 17,009
Notes:				Various	\$ 577

(1) Amounts related to the merger of Cerro and Cerro-Marmon. See Notes 1 and 2 of Notes to Consolidated Financial Statements included in Cerro-Marmon's 1976 annual report to shareholders and incorporated herein by reference.  
(2) Cash dividends.  
(3) Reconciliation to the consolidated financial statements:

Real estate subsidiaries	Amount shown above	Advances (Schedule IV)	Amount shown in consolidated financial statements
	\$ 542	\$ 19,493	\$ 20,035

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## CERRO-MARMON CORPORATION

SCHEDULE IV - INDEBTEDNESS OF AFFILIATES AND OTHER PERSONS -  
NOT CURRENT

Column A	Column B	Column C
Name of Person	Balance at Beginning Of period	Balance at End Of period
1976		
Real estate subsidiaries		\$ <u>19,493</u>

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## CERRO-MARMON CORPORATION

## SCHEDULE V - PROPERTY, PLANT AND EQUIPMENT

For the Years Ended December 31, 1976 and 1975  
(In thousands of dollars)

Col. A	Col. B	Col. C		Col. D	Col. E
Classification	Balance at Begin- ning of Period	Additions at Cost Acquisi- tion (Note)	Other	Retire- ments	Balance at End of Period
1976					
Land	\$ 2,064	\$ 850	\$ 865	\$	\$ 3,779
Buildings and improvements	21,590	7,014	3,392	434	31,562
Machinery and equipment	34,027	19,697	13,664	3,230	64,158
Mining properties		21,537		1,273	20,264
Utility plant		2,916	3,306	24	6,198
Construction in progress	424	9,710	(3,570)	292	6,272
	<u>\$ 58,105</u>	<u>\$ 61,724</u>	<u>\$ 17,657</u>	<u>\$ 5,253</u>	<u>\$132,233</u>
1975					
Land	\$ 1,553		\$ 589	\$ 78	\$ 2,064
Buildings and improvements	18,040		5,461	1,911	21,590
Machinery and equipment	31,012		6,343	3,328	34,027
Construction in progress	5,713		(5,270)	19	424
	<u>\$ 56,318</u>		<u>\$ 7,123</u>	<u>\$ 5,336</u>	<u>\$ 58,105</u>

## Note:

Acquisition of Cerro Corporation (see Notes 1 and 2 of Notes to Consolidated Financial Statements included in Cerro-Marmon's 1976 annual report to shareholders and incorporated herein by reference).

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## SCHEDULE VI

## CERRO-MARMON CORPORATION

SCHEDULE VI - ACCUMULATED DEPRECIATION, DEPLETION AND  
AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT

For the Years Ended December 31, 1976 and 1975  
(In thousands of dollars)

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F
Description	Balance at Begin- ning of Period	Additions Charged to Costs and Expenses	Retire- ments	Other Changes (Note)	Balance at End of Period
1976					
Buildings and improvements	\$ 5,448	\$ 1,533	\$ 295	\$ 135	\$ 6,821
Machinery and equipment	16,436	7,504	1,194	1,908	24,654
Mining properties		293		219	512
Utility plant		130		24	154
	<u>\$ 21,884</u>	<u>\$ 9,460</u>	<u>\$ 1,489</u>	<u>\$ 2,286</u>	<u>\$ 32,141</u>
1975					
Buildings and improvements	\$ 5,576	\$ 938	\$ 1,066		\$ 5,448
Machinery and equipment	14,718	4,270	2,552		16,436
	<u>\$ 20,294</u>	<u>\$ 5,208</u>	<u>\$ 3,618</u>		<u>\$ 21,884</u>

## Note:

Represents Cerro-Marmon's basis in accumulated depreciation of Cerro Corporation at February 24, 1976 on 45.33% of assets acquired by Cerro subsequent to August 1, 1974 (see Notes 1 and 2 of Notes to Consolidated Financial Statements included in Cerro-Marmon's 1976 annual report to shareholders and incorporated herein by reference).

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## CERRO-MARMON CORPORATION

## SCHEDULE XII - VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

For the Years Ended December 31, 1976 and 1975  
(In thousands of dollars)

Col. A	Col. B	Col. C	Col. D	Col. E
Description	Balance at Begin- ning of Period	Additions Charged to Costs and Expenses	Deductions	Balance at End of Period
1976				
Current trade receivables	\$ 1,464	\$ 1,713	\$ 548	\$ 2,629
Inventory valuation reserves	\$ 1,939	\$ 4,045	\$ 1,487	\$ 4,497
1975				
Current trade receivables	\$ 1,087	\$ 649	\$ 269	\$ 1,464
Inventory valuation reserves	\$ 1,343	\$ 1,000	\$ 404	\$ 1,939

LS 000747

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholder of  
Leadership Housing, Inc.  
(A wholly-owned subsidiary of Cerro-Marmon Corporation)

We have examined the consolidated balance sheets before quasi-reorganization of Leadership Housing, Inc. and its subsidiaries as of December 31, 1976 and 1975, and the related consolidated statements of operations and accumulated deficit and of changes in financial position for the years then ended. We have also examined the consolidated balance sheet after quasi-reorganization of Leadership Housing, Inc. and its subsidiaries as of December 31, 1976. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements for 1976 of Boca del Mar Associates and Boca del Mar Golf and Tennis Club, partnerships in which the Company has net investments in and advances to of \$6,537,000 and \$6,188,000, respectively before and after the quasi-reorganization as of December 31, 1976 and equity in losses of \$1,414,000 for the year ended December 31, 1976. In addition, we did not examine the financial statements for 1976 of The Housing Group and The Communities Group, Inc. of Broward County, in which the Company has investments in and advances to amounting to \$4,755,000 as of December 31, 1976. These statements were examined by other auditors whose reports thereon have been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for the above mentioned partnerships and affiliated companies, is based solely upon the reports of the other auditors.

As discussed in Note 2, on March 15, 1977, the Company's parent, Cerro-Marmon Corporation, authorized the Company to effect a quasi-reorganization to establish a new accounting basis for its consolidated assets and liabilities based on their fair values as of December 31, 1976 and to eliminate the accumulated deficit by transferring it to additional paid-in capital. The consolidated balance sheet after quasi-reorganization of Leadership Housing, Inc. and its subsidiaries as of December 31, 1976 has been prepared accordingly.

LS 000748

As described in Note 3, certain notes and other receivables are involved in litigation and the collectibility of such receivables is uncertain. As described in Note 12, the Company is involved in other pending and threatened litigation related to existing and potential claims, the outcome of which is uncertain. It is probable that losses related to such receivables and claims have been incurred and provisions for such losses, where reasonably estimable, have been recorded as of December 31, 1976 before quasi-reorganization. In the quasi-reorganization provision has been made for the maximum losses on such receivables and claims.

As described in Note 12, the Company is contingently liable for approximately \$18,200,000 of notes payable of one of its joint ventures. These notes payable are in default and actions for foreclosure have been filed by certain note holders. It cannot be determined at this time whether a loss related to this contingency is probable and no provision has been recorded in the financial statements as of December 31, 1976 for any such loss that may result on resolution of this contingency.

In our opinion, based upon our examinations and the reports of other auditors, subject to the effects of such adjustments, if any, as might have been required had the outcome of the uncertainties referred to in the preceding two (2) paragraphs been known, the consolidated financial statements examined by us present fairly (1) the financial position before quasi-reorganization of Leadership Housing, Inc. and its subsidiaries at December 31, 1976 and 1975, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied and (2) the financial position after quasi-reorganization of Leadership Housing, Inc. and its subsidiaries at December 31, 1976 in conformity with generally accepted accounting principles.

*Price Waterhouse & Co.*

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LEADERSHIP HOUSING, INC.  
(A Wholly-Owned Subsidiary of Cerro-Marmon Corporation)  
CONSOLIDATED BALANCE SHEETS  
(In Thousands)

	<u>December 31,</u>		
	<u>1976</u>		<u>1975</u>
<u>Assets</u>	After Quasi-reorganization (Note 2)	Before Quasi-reorganization	
Cash, including restricted cash of \$760 in 1976	\$ 2,582	\$ 2,582	\$ 1,951
Notes and other receivables (Notes 3, 8, and 12)	17,573	18,856	27,966
Notes receivable secured by all- inclusive trust deeds receivable less underlying trust deed notes payable (Notes 3 and 8)	8,937	8,885	8,880
Inventories (Notes 4, 8, and 12)	66,819	67,035	113,721
Investments in and advances to:			
Affiliated companies (Note 5)	4,755	4,755	
Joint ventures, net (Notes 6, 8, and 12)	6,005	6,354	8,007
Property, plant and equipment, net (Notes 7 and 8)	4,745	6,046	4,093
Other assets	1,187	1,568	2,876
	<u>\$112,603</u>	<u>\$116,081</u>	<u>\$167,494</u>
<u>Liabilities</u>			
Notes payable (Note 8)	\$ 64,697	\$ 68,737	\$102,090
Accounts payable	789	586	3,623
Accrued liabilities	7,677	11,524	7,417
Customer deposits	4,107	4,107	5,527
Rent guarantees	1,544	1,544	2,839
Deposits on property sold subject to repurchase (Note 12)	7,244	7,244	7,244
Deferred income		2,804	2,836
Due to parent company, net (Note 10)	14,849	19,298	16,035
	<u>100,907</u>	<u>115,844</u>	<u>147,611</u>
<u>Stockholder's Equity (Notes 2 and 11)</u>			
Series A preferred stock	11,695	11,695	11,695
Common stock	1	1	1
Additional paid-in capital		41,249	41,249
Accumulated deficit		( 52,708)	( 33,062)
	<u>11,696</u>	<u>237</u>	<u>19,883</u>
	<u>\$112,603</u>	<u>\$116,081</u>	<u>\$167,494</u>

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LEADERSHIP HOUSING, INC.

(A Wholly-Owned Subsidiary of Cerro-Marmon Corporation)

CONSOLIDATED STATEMENTS OF OPERATIONS AND ACCUMULATED DEFICIT

(In Thousands)

(See Note 2 regarding quasi-reorganization)

	For the years ended December 31,	
	1976	1975
Sales:		
Single family	\$14,078	\$32,704
Multi-family	5,848	4,758
Land	4,694	3,154
Land sold to affiliated companies (Note 5)	2,993	
Other	<u>2,266</u>	<u>3,874</u>
	<u>29,879</u>	<u>44,490</u>
Cost of sales:		
Single family	13,570	31,616
Multi-family	5,864	6,161
Land	4,767	2,978
Land sold to affiliated companies (Note 5)	2,993	
Other	<u>3,770</u>	<u>5,729</u>
	<u>30,964</u>	<u>46,484</u>
Provision for writedowns of inventories (Note 4)	<u>6,034</u>	<u>8,700</u>
Costs in excess of sales	<u>( 7,119)</u>	<u>(10,694)</u>
Other (costs) income:		
Equity in net losses of joint ventures (Note 6)	( 1,483)	( 554)
Sales and marketing	( 1,140)	( 2,467)
General and administrative (Note 12)	( 6,241)	( 7,856)
Interest income	5,418	6,520
Interest costs accrued	(11,428)	(16,197)
Less interest capitalized (Note 13)	2,347	6,685
Write-off of goodwill (Note 1)		( 8,040)
Stock option and warrant expense (Note 11)		( 1,040)
Gain on sale of utility system (Notes 7 and 8)		<u>2,630</u>
	<u>(12,527)</u>	<u>(20,319)</u>
Loss before income taxes	(19,646)	(31,013)
Income tax benefit (Note 9)		<u>1,170</u>
Net loss	(19,646)	(29,843)
Accumulated deficit:		
At beginning of year	(33,062)	( 3,219)
At end of year	<u>(52,708)</u>	<u>(\$33,062)</u>
Adjustment in quasi-reorganization (Note 2)	<u>52,708</u>	
	<u>\$ -</u>	

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LEADERSHIP HOUSING, INC.

(A Wholly-Owned Subsidiary of Cerro-Marmon Corporation)

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

(In Thousands)

(See Note 2 regarding quasi-reorganization)

	For the years ended December 31,	
	<u>1976</u>	<u>1975</u>
Financial resources were provided by:		
Proceeds from borrowings and parent company advances	\$ 4,968	\$12,605
Additional paid-in capital		728
Proceeds from sale of utility system to parent company		11,884
Transfer of assets to an affiliated company	25,101	
Decrease in notes and other receivables	6,125	3,269
Decrease in inventories	15,776	2,318
Decrease (increase) in investment in joint venture	170	( 39)
Decrease in other assets	1,308	1,907
Increase in rent guarantees	388	82
Increase in deposits on property subject to repurchase		8
Total provided	<u>53,836</u>	<u>32,762</u>
Financial resources were used for:		
Net loss from operations	19,646	29,843
Add (deduct) items not requiring cash:		
Deferred income taxes		1,170
Depreciation and amortization	( 166)	( 595)
Undistributed losses of joint ventures	( 1,483)	( 554)
Provision for writedowns	( 6,034)	( 8,700)
Writeoff of goodwill		( 8,040)
Stock option and warrant expense		( 312)
Gain on sale of utility system		2,630
Gain on rent guarantee settlement	410	
	<u>12,373</u>	<u>15,442</u>
Reductions of borrowings and parent company advances	17,461	13,659
Liabilities assumed by an affiliated company	18,123	
Cancellation of debt by an affiliated company	1,478	
Preferred stock in an affiliated company	2,500	
Increase in advances to affiliated companies	2,255	
(Dispositions of) additions to property, plant and equipment, net	( 613)	924
(Increase) decrease in accounts payable and accrued liabilities	( 1,824)	4,640
Decrease in customer deposits	1,420	449
Decrease in deferred income	32	385
Total used	<u>53,205</u>	<u>35,499</u>
Increase (decrease) in cash	<u>\$ 631</u>	<u>(\$ 2,737)</u>

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LEADERSHIP HOUSING, INC.

(A Wholly-Owned Subsidiary of Cerro-Marmon Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - Accounting Principles and Policies:

The major accounting principles and policies used by the Company are described below.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All material intercompany balances and transactions have been eliminated.

Recognition of Revenue

Sales of single family houses and condominiums are recorded when escrow closes, title has passed to the buyer and cash has been received for substantially the full sales price. At that time, land costs, allocated site development, construction costs, capitalized interest and real estate taxes are relieved from inventory and charged to cost of sales along with a provision for sales commissions and estimated miscellaneous warranty costs. Customer down payments and payments of specified amounts at certain stages of construction prior to closing are recorded as customer deposits.

Sales of recreational facilities, developed and undeveloped land are recorded at the time escrow closes and the Company has received the required cash down payment and all other conditions necessary for profit recognition have been satisfied.

Sales and profits on land sold which the Company is required to develop are recognized over the development period in the ratio of costs incurred to estimated total costs at completion providing future costs can be reasonably quantified.

Sales of land which the Company intends or is obligated to repurchase are considered financing arrangements and are not recorded as sales and cash received from the buyer is recorded as deposits on property sold subject to repurchase. Costs of land and improvements applicable to such sales are retained in inventories and the related notes receivable are not recorded. Interest received on the unrecorded notes is recorded as additional deposits on property sold subject to repurchase.

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Multi-family projects are generally sold to investors subject to physical construction and minimum cash flow guarantees. Where minimum cash flow guarantees exist, a sale is not recorded until the project achieves a cash flow sufficient to provide for all operating expenses and guarantee requirements. Once this level of operation is achieved, profits are recognized in the ratio of costs incurred to date to estimated total costs at completion over the period of performance including the guarantee period. Costs include anticipated operating expenses of the property during the guarantee period. Anticipated gross rental income during the guarantee period is reduced by an appropriate margin and is recorded as additional rent guarantee reserve. Costs of land and improvements on multi-family projects which have not satisfied all conditions for income recognition are included in inventory, amounts of investors' payments are reflected as deposits and the related notes receivable secured by all-inclusive trust deeds are not recorded on the balance sheet. Profits, if any, which might result from projects sold which have continuing seller involvement or cash flow guarantees over extended periods up to 30 years have been deferred and included as additional rent guarantee reserve until such time as the guarantees expire.

#### Other Sales and Cost of Sales

Other sales and cost of sales include operations, such as country club and utility operations, which do not fall within the principal product lines and certain production related costs expensed currently which cannot be practicably allocated to specific product lines.

#### Inventories (See Note 2)

Inventories are carried at cost or estimated net realizable value whichever is lower. The estimated net realizable value of inventories is evaluated based on disposition of inventories in the normal course of business under existing and anticipated market conditions. The evaluation takes into consideration the current status of the property, various restrictions, carrying costs, debt service requirements, and any other circumstances which may affect net realizable value including management plans for the property. Due to the large acreage of certain land holdings, disposition in the normal course of business may extend over a number of years.

The cost basis for land includes interest and real estate taxes. Site development is at average cost and construction is at specific cost. Single and multi-family inventory consists of land, land improvements, construction costs and other capitalizable

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costs including interest and real estate taxes for projects currently under development. Land and improvements applicable to single family construction and multi-family projects are transferred to such inventory captions when construction commences.

The cost of properties included in inventories as a result of foreclosure by the Company includes the unpaid balance of the note receivable and accrued interest plus the balance of any related notes payable to be assumed by the Company at completion of the foreclosure action. Such properties are included in the inventories when the note receivable secured only by real estate is in default, the Company has determined that payments will not be received, and legal action to recover the property has been instituted.

#### Property, Plant and Equipment (See Note 2)

Property, plant and equipment is carried at cost and is depreciated by the straight-line method over the estimated useful lives of the assets. Costs of additions and major improvements are capitalized and expenditures for maintenance and repairs are expensed. When property or equipment is retired or sold, any profit or loss on the transaction is recognized currently.

The estimated useful lives of property, plant and equipment are indicated below:

	<u>Years</u>
Buildings and structures	25
Utility system	40
Leasehold improvements	Term of lease
Machinery and equipment	4
Furniture and fixtures	6

#### Deferred Income (See Note 2)

Deferred income consists primarily of prepaid interest, which is amortized into income over a specified term; deferred profit on multi-family projects, which is amortized into income over the construction and guarantee period; and deferred profit on a sale of land recorded on the instalment method.

#### Goodwill

The excess of the price paid by Cerro over the book value of Leadership was allocated 50% to land and 50% to goodwill. The amount included in land is charged to cost of sales when land is sold. Goodwill amortization was over forty years commencing in 1972 and amounted to \$222,000 for the six months ended June 30, 1975. Because of the inventory reduction program, described in Note 4, it was determined that goodwill in the amount of \$8,040,000, representing the unamortized excess of purchase price over the net assets of the Company as of June 30, 1975 had no continuing benefit and it was therefore written off.

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NOTE 2 - The Company:

Leadership Housing, Inc. is a wholly-owned subsidiary of Cerro-Marmon Corporation (Cerro), which is the successor to Cerro Corporation as the result of a merger on February 24, 1976. Cerro is a majority owned subsidiary of GL Corporation (GL), which is owned by the Pritzker Family. Certain members of the Pritzker Family are owners of beneficial interests in trusts (Pritzker Trusts) which are in certain joint ventures with the Company.

During 1976 the Company changed its manner of operation and is no longer involved in the construction and sale of single family houses, condominiums and multi-family projects other than for the completion of certain minor projects previously in progress. In connection with the change the Company transferred and sold a significant amount of assets and liabilities to affiliated companies as more fully described in Note 5. In addition, substantially all operating and administrative personnel employed by the Company became employees of affiliated companies by January 1, 1977. On February 22, 1977 the Company and the bank agreed to a restructuring of the Company's debt (Note 8) and the Company and the Pritzker Trusts agreed to cancel each other's rights and obligations in connection with the repurchase and other related agreements (Note 12).

In view of the significance of the changes in operations and financial position, the Company with the formal approval of Cerro as the sole stockholder effected a quasi-reorganization of the Company as of December 31, 1976. In the quasi-reorganization the Company established a new accounting basis where appropriate as more fully described herein for its consolidated assets and liabilities based on their fair values as of December 31, 1976, received an additional capital contribution of approximately \$4,449,000 of amounts previously due Cerro, and eliminated the accumulated deficit by charging it against additional paid-in capital. The restructuring of debt and the cancellation of agreements subsequent to December 31, 1976 referred to in the preceding paragraph have been considered in establishing the new accounting basis for the related assets and liabilities in the quasi-reorganization.

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The adjustments in quasi-reorganization are summarized in the following analysis of changes in additional paid-in capital (in thousands):

	For the years ended December 31,	
	1976	1975
At beginning of year	\$41,249	\$40,209
Capital contribution		1,040
At end of year	41,249	<u>\$41,249</u>
Adjustments in quasi-reorganization:		
Net writedowns of inventories and property, plant and equipment	( 3,266)	
Elimination of deferred income	2,804	
Net effect of present value adjustment of notes receivable and notes payable excluding notes involved in subsequent restructuring of debt	562	
Provision for notes receivable, claims and litigation	( 2,732)	
Other, net	( 133)	
Adjustment resulting from subsequent restructuring of debt (Note 8)	8,276	
Increase in inventories resulting from subsequent cancellation of repurchase obligation (Note 12)	1,499	
Capital contribution	4,449	
Accumulated deficit charged to additional paid-in capital	( <u>52,708</u> )	
	<u>\$ -</u>	

If the adjustments are subsequently found to have been excessive or insufficient, the differences will be charged or credited to additional paid-in capital, if there have been no changes in circumstances subsequent to the quasi-reorganization. The tax benefits of loss carryforwards arising prior to the quasi-reorganization will be added to additional paid-in capital, if realized in subsequent years (Note 9).

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The following procedures were used by the Company in determining the fair value of assets and liabilities.

Notes receivable, excluding the notes sold subsequent to December 31, 1976, were discounted to yield an effective interest rate of eight to ten percent (8-10%), which is considered appropriate for the Company's notes receivable. Notes receivable sold subsequently by the Company were adjusted to their sales value (Note 8).

As described in Note 3, certain receivables aggregating approximately \$1,609,000 are in litigation as of December 31, 1976 and the collectibility of the receivables is uncertain at this time. Based on information currently available it is probable that losses on these receivables have been incurred and in accordance with Accounting Research Bulletin No. 43, the Company has provided for the estimated maximum loss of \$1,494,000 in the quasi-reorganization.

Inventories and property, plant and equipment were increased or decreased to their estimated fair values based upon independent appraisals, contracts and management estimates as of December 31, 1976. In addition, land previously sold with an obligation to repurchase, which was not recorded as a sale and therefore included in inventory was valued at its sales price (which is equivalent to cash previously received and shown as deposits on property sold subject to repurchase) since the obligation to repurchase was subsequently cancelled. Of the combined \$73,081,000 of inventories and property, plant and equipment before the quasi-reorganization \$43,268,000 (59%) was based on appraisals and \$18,030,000 (25%) was based upon contracts and cancellation of the buy back agreement with the balance determined by management estimates.

The investments in and advances to affiliated companies and the amount due to parent company were not adjusted due to the nature of the relationship which exists between such related parties.

The fair value of the investment in two joint ventures was determined to reasonably approximate the book value as of December 31, 1976 based on independent appraisals. Another joint venture, which was appraised by an independent appraiser, was not adjusted in that the Company has no investment and at this time is not required to make any capital contributions. The fourth venture in which the Company has no investment is presently in default on its notes payable (Note 12) and therefore because the Company may elect alternative courses of action based on subsequent developments, a determination of fair value is not considered practicable at this time.

Notes payable (other than notes payable with interest rates that are based upon the prime rate and considered to be stated at fair value) were discounted to provide for an effective annual interest rate of eight to ten percent (8-10%), which is considered to be appropriate for the Company's notes payable.

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Accrued liabilities were reduced by the subsequent forgiveness of accrued interest on the bank term loan agreement (Note 8).

As described in Note 12, the Company is involved in pending and threatened litigation related to existing and potential claims, the outcome of which is uncertain at this time. Based on information currently available it is probable that losses have incurred and in accordance with Accounting Research Bulletin No. 43 the provision for losses from such claims recorded before the quasi-reorganization has been increased to the estimated maximum loss of \$2,150,000 in the quasi-reorganization.

Deferred income which consisted principally of deferred profit and prepaid interest income has been eliminated in the process of valuing the related assets.

The following condensed statement gives effect on a pro-forma basis as of December 31, 1976 after quasi-reorganization to the restructuring of debt and the cancellation of the Company's repurchase obligations subsequent to December 31, 1976 (Notes 8 and 12) (in thousands):

	December 31, 1976	Pro-forma adjustments	Pro-forma
Cash	\$ 2,582		\$ 2,582
Receivables, net	26,510	(\$14,839)(1)	11,671
Inventories	66,819	( 7,244)(2)	59,575
Investments in affiliated companies	4,755	343 (1)	5,098
Other assets, investments and property and equipment, net	<u>11,937</u>		<u>11,937</u>
	<u>\$112,603</u>	<u>(\$21,740)</u>	<u>\$90,863</u>
Notes payable	\$ 64,697	(\$19,050)(1)	\$45,647
Accounts payable	789	456 (1)	1,245
Accrued and other liabilities	13,328		13,328
Deposits on property sold subject to repurchase	7,244	( 7,244)(2)	-
Due to parent company	<u>14,849</u>	<u>4,098 (1)</u>	<u>18,947</u>
	100,907	( 21,740)	79,167
Stockholder's equity	<u>11,696</u>		<u>11,696</u>
	<u>\$112,603</u>	<u>(\$21,740)</u>	<u>\$90,863</u>

- (1) The sale of certain notes receivable to third parties and The Housing Group, transfer to the bank of a note receivable from Cerro, advances from Cerro and the repayment of debt (Note 8).
- (2) The cancellation of the Company's obligation and option to repurchase property previously sold to the Pritzker Trusts (Note 12).

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NOTE 3 - Receivables:

Notes and other receivables at December 31, 1976 and 1975 consist of the following (in thousands):

	<u>1976</u>		<u>1975</u>
	After	Before	
	<u>Quasi-reorganization</u>		
Notes			
First trust deeds	\$13,125	\$12,954	\$16,142
Second trust deeds	2,128	2,918	7,524
Other	<u>443</u>	<u>445</u>	<u>399</u>
	<u>15,696</u>	<u>16,317</u>	<u>24,065</u>
Other receivables			
(including \$358,000,			
\$968,000 and \$1,719,000			
due from Pritzker Trusts*)			
less allowance for un-			
collectibility of \$346,000,			
\$346,000 and \$406,000			
respectively	<u>1,877</u>	<u>2,539</u>	<u>3,901</u>
	<u>\$17,573</u>	<u>\$18,856</u>	<u>\$27,966</u>

\* The beneficiaries of the Pritzker Trusts are members of the Pritzker family, including Mr. J. A. Pritzker (Chairman of the Board of Directors of Cerro) and Mr. R. A. Pritzker (President of Cerro). The Pritzker family is also the beneficial owner of 100% of the outstanding common shares of Cerro.

Notes receivable secured by all-inclusive trust deeds receivable less underlying trust notes payable are summarized as follows (in thousands):

	<u>1976</u>		<u>1975</u>
	After	Before	
	<u>Quasi-reorganization</u>		
Receivables	\$44,164	\$44,768	\$49,756
Payables	( 35,227 )	( 35,883 )	( 40,876 )
Net	<u>\$ 8,937</u>	<u>\$ 8,885</u>	<u>\$ 8,880</u>

As described in Note 8, subsequent to December 31, 1976 the Company sold certain notes receivable.

First trust deed notes receivable arise from the sales of land and recreational facilities which mature from the date of sale within 10 years for land and 30 years for recreational facilities. Such receivables are secured by the related land and recreational facilities.

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Second trust deeds arise primarily from the sales of single family residences and certain sales of land. Receivables due from single family home sales, which are subordinated to first trust deeds held by financial institutions are due in monthly instalments of principal and interest for periods averaging nine years.

Notes receivable secured by all-inclusive trust deeds less underlying trust deed notes payable are due in annual instalments of up to 30 years.

Notes and other receivables (including notes receivable secured by all-inclusive trust deed notes less underlying trust deed notes payable) mature by their terms in varying instalments. The net amount due within one year after the sale of certain of these notes subsequent to December 31, 1976 is \$2,343,000.

Second trust deeds receivable before the quasi-reorganization include a \$999,000 receivable due December 31, 1975 which is currently in default and which is secured by real estate. A court ordered sale of the real estate securing the note has been set for 1977, the proceeds of which are to be distributed to the Company and the holders of other debt secured by the property. Other receivables before the quasi-reorganization include a \$610,000 unsecured receivable due from the Pritzker Trusts representing approximately 50% of the profit from the sales of property in 1974 by the Trusts to third parties (Note 12). Certain of the purchasers are seeking rescission of the contracts, and if they are successful, the Company would not be entitled to receive the \$610,000. Based on the information currently available it is probable that losses have been incurred and although the Company cannot estimate the exact amount of the loss, its reasonable estimate is that such losses would not exceed \$1,494,000. See Note 2 for losses provided for in the quasi-reorganization.

At December 31, 1976 and 1975, there are unrecorded notes receivable aggregating \$10,908,000 and \$16,965,000 (\$2,980,000 and \$2,980,000 from Pritzker Trusts), respectively, which resulted from sales of land and sales of multi-family projects which have not satisfied all conditions for sales and income recognition. The portion of these notes due within one year by their terms aggregates approximately \$391,000 and \$1,558,000 as of December 31, 1976 and 1975.

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NOTE 4 - Inventories:

Inventories at December 31, 1976 and 1975 consist of the following (in thousands):

	<u>1976</u>	<u>1975</u>
	<u>After</u> <u>Quasi-reorganization</u>	<u>Before</u>
Land and improvement costs	\$47,736	\$49,838
Single family construction	1,819	1,819
Multi-family projects	10,020	9,883
Land sold subject to repurchase from Pritzker Trusts (Note 12)	<u>7,244</u>	<u>5,495</u>
	<u>\$66,819</u>	<u>\$113,721</u>

Land and improvement costs at December 31, 1976 and 1975 include \$135,000, \$385,000 and \$7,577,000, respectively for properties upon which the Company has filed actions for foreclosure.

The provision for the writedowns of inventories to estimated net realizable values and related items consist of the following (in thousands):

	<u>December 31,</u>
	<u>1976*</u> <u>1975</u>
Reduction of inventories to estimated net realizable value:	
Housing	\$ 800
Land and improvements	<u>7,900</u>
	<u>\$6,034</u> <u>\$8,700</u>

\*Before quasi-reorganization

On August 13, 1975 a plan was announced whereby the Company intended to significantly reduce total assets, of which inventories were the significant portion. As of December 31, 1976, the planned reduction of total assets had not been completed and therefore uncertainties existed as to the amount and timing of the ultimate realization upon disposition of land and improvement inventories. As described in Notes 8 and 12 subsequent to December 31, 1976 the Company restructured its debt and cancelled certain agreements whereby the Company substantially accomplished its objective of reducing total assets. It is the present plan and intention of Cerro to continue its financial support of the Company to the extent necessary to achieve the orderly disposition of the Company's remaining inventories in the normal course of business, which has removed the aforementioned uncertainties.

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NOTE 5 - Investment in and Advances to Affiliated Companies:

The investment in and advances to affiliated companies at December 31, 1976 both before and after quasi-reorganization consist of the following (in thousands):

Investment in preferred stock of The Housing Group	\$2,500
Accounts receivable from the Communities Group	505
Notes receivable secured by real estate due from the Communities Group	<u>1,750</u>
	<u>\$4,755</u>

In connection with the decision to significantly change the operations of the Company (Note 2), effective April 1, 1976 the Company transferred certain assets and liabilities to The Housing Group, a newly formed wholly-owned subsidiary of Cerro. The assets transferred were principally the Company's single family inventories of land, construction in progress and finished homes located in California and the related debt. The assets of \$25,101,000 and liabilities of \$18,123,000 were transferred at their book value to The Housing Group. In consideration for the transfer of the assets the Company received \$2,500,000 of preferred stock Series A, \$1.00 par value, a note receivable of \$3,000,000 (subsequently collected) and the cancellation of certain inter-company debt of \$1,478,000. The sales and costs related to the Company's single family operations in California for the three months ended March 31, 1976 (the period prior to the transfer) and for the year ended December 31, 1975 included in the statements of operations are as follows: sales \$3,316,000 and \$17,370,000, cost of sales \$3,024,000 and \$17,120,000, respectively.

Concurrent with the transfer of the assets, The Housing Group entered into a services agreement with the Company, whereby The Housing Group will provide management services for the Company with respect to properties situated in California, Texas and Hawaii. The Series A preferred stock provides for 1% dividends, non-cumulative and preference in liquidation to the extent of the par value plus declared and unpaid dividends. Commencing with the year ending December 31, 1977 a sinking fund must be established to be used to redeem shares annually. The Housing Group is required to contribute to the sinking fund an amount approximately equal to fifty percent (50%) of its net income. In the event that the required dividends or sinking fund payments are not made, the Company becomes entitled to elect a majority of the Board of Directors of The Housing Group.

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During 1976, GL Corporation formed The Communities Group, Inc. of Broward County (the Communities Group) for the purpose of purchasing land from the Company. As of December 31, 1976 the Company had sold to the Communities Group approximately \$2,243,000 of land subject to existing indebtedness of approximately \$333,000 for which the Company received approximately \$1,750,000 of notes secured by real estate, subject to future subordination, and unsecured receivables of approximately \$160,000. These properties were sold to the Communities Group at the Company's book value and are included in sales and cost of sales. In addition to the assets transferred, the Company subsequently sold to The Housing Group approximately \$750,000 of land which was at the Company's approximate book value and is included in sales and cost of sales.

NOTE 6 - Investments in and Advances to Joint Ventures:

The investments in and advances to joint ventures, net at December 31, 1976 and 1975 consist of the following (in thousands):

	<u>1976</u>		<u>1975</u>
	After	Before	
	<u>Quasi-reorganization</u>		
Investment	\$4,480(1)	\$4,480	\$5,963
Notes receivable due in annual instalments of principal and interest through 1979	4,247	4,596	4,596
Notes payable due in annual instalments of principal and interest through 1979	( 2,722)	( 2,722)	( 2,809)
Interest receivable, net			257
	<u>\$6,005</u>	<u>\$6,354</u>	<u>\$8,007</u>

(1) See Note 2 for discussion of estimated fair value.

The accounting policies and principles followed by the joint ventures insofar as they relate to revenue and profit recognition are the same as those being followed by the Company.

The Company is a participant in two joint ventures with the Pritzker Trusts each of which provides for participation in 50% of profits and losses. At December 31, 1976 and 1975, these two ventures which hold unimproved property have not made any sales. In addition, the Company is a participant in another joint venture with an independent third party, which is developing and selling property. Effective January 1, 1976 this joint venture agreement was amended whereby the Company will be allocated all losses for a portion of the venture until such time that the Company and its partner have an equal interest in profits and losses. Prior to the amendment the Company participated in 50% of profits only (not losses) for approximately 40% of the unsold property being developed and 50% of profits and losses for the other 60% of the property. In January 1975, two golf courses and related facilities were transferred from this joint venture to a new joint venture in which the Company participates in 50% of profits and losses.

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In all four of these ventures the Company has no obligation to make any capital contributions except, in certain cases, in the event of dissolution of the ventures. However, to the extent the other participants make such contributions preference will be made as to ultimate distributions for such contributions as well as an interest factor thereon.

In connection with a mortgage modification agreement, the Company has subordinated their \$4,596,000 note receivable from the joint venture with the independent third party from a second to a third position and has extended the maturity date to December 31, 1979 and waived all principal payments until certain matters relating to litigation have been resolved.

A condensed Combined Balance Sheet at December 31, 1976 and 1975, and condensed Combined Statement of Operations for the years then ended for the ventures follows:

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12-11  
12-11

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Combined Balance Sheets  
(In Thousands)

	<u>December 31,</u>	
	<u>1976</u>	<u>1975</u>
<u>Assets</u>		
Cash	\$ 618	\$ 553
Notes and other receivables (\$1,494 and \$1,654 due within one year)	10,133	18,709
Notes receivable from Leadership (\$148 due within one year)	2,722	2,809
Inventories of land and site development (Note 4)	84,761	69,748
Golf courses and related facilities	3,287	3,432
	<u>\$101,521</u>	<u>\$95,251</u>
<u>Liabilities</u>		
Accounts payable and accrued liabilities	\$ 6,177	\$ 2,808
Commissions payable to Leadership	267	336
Notes and mortgages payable (\$37,219 and \$9,048 due within one year) (Note 12)	68,027	64,362
Notes payable to Leadership	4,596	4,596
Deferred income	132	75
Customer deposits	24	279
	<u>79,223</u>	<u>72,456</u>
<u>Equity</u>		
Leadership Housing, Inc.	4,480	5,963
Joint venture partners	17,818	16,832
	<u>\$101,521</u>	<u>\$95,251</u>

Combined Statements of Operations  
(In Thousands)

	<u>For the years ended</u> <u>December 31,</u>	
	<u>1976</u>	<u>1975</u>
Sales and other revenues	\$ 2,492	\$ 949
Cost of sales	2,591	1,786
Cost in excess of sales	( 99)	( 837)
General and administrative expense	( 590)	( 526)
Interest income	862	1,007
Interest expense	( 2,098)	( 1,962)
Miscellaneous, net		44
Loss before taxes (a)	<u>(\$ 1,925)</u>	<u>(\$ 2,274)</u>
Leadership Housing, Inc. equity in loss	<u>(\$ 1,483)</u>	<u>(\$ 554)</u>

(a) No provision has been made for income taxes since the loss is included in the respective partners' tax returns.

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NOTE 7 - Property, Plant and Equipment:

At December 31, 1976 and 1975 the major classifications of property, plant and equipment are as follows (in thousands):

	After <u>Quasi-reorganization</u>	<u>1976</u> Before	<u>1975</u>
Land and land improvements	\$ 997	\$1,041	\$1,078
Buildings, equipment, furniture and fixtures	70	739	1,148
Golf courses and related facilities	<u>3,833</u>	<u>4,923</u>	<u>2,493</u>
	4,900	6,703	4,719
Less accumulated depreciation	( <u>155</u> )	( <u>657</u> )	( <u>626</u> )
	<u>\$4,745</u>	<u>\$6,046</u>	<u>\$4,093</u>

Depreciation amounted to \$166,000 and \$373,000 for the years ended December 31, 1976 and 1975, respectively. Golf courses and related facilities at December 31, 1976 include \$1,206,000 for a golf course, upon which the Company has filed an action for foreclosure.

On June 18, 1975, and in connection with the banking arrangements made on that date as described in Note 8, the utility system was sold to Cerro Corporation resulting in a gain to the Company as shown separately in the statement of operations. The operations of the utility system through the date of sale, June 18, 1975 included in other sales and cost of sales in the statement of operations for the year ended December 31, 1975 are as follows (in thousands):

Sales	\$1,227
Cost of sales	<u>779</u>
Gross profit	<u>\$ 448</u>

NOTE 8 - Notes Payable:

At December 31, 1976 and 1975, notes payable consist of the following (in thousands):

	After <u>Quasi-reorganization</u>	<u>1976</u> Before	<u>1975</u>
Obligations to banks:			
Notes payable - bank term loan agreement (a)	\$39,000	\$42,444	\$ 44,281
Other:			
7% to prime plus 5.5% real estate mortgages payable in instalments through 2011	24,026	24,470	55,278
6-8% unsecured notes payable in instalments through 1982	<u>1,671</u>	<u>1,823</u>	<u>2,531</u>
	<u>\$64,697</u>	<u>\$68,737</u>	<u>\$102,090</u>

(a) As of December 31, 1976 and 1975, the Company had a loan agreement with a bank acting for itself and as representative for others. The maximum amount allowed by the agreement was \$54,500,000; a \$44,500,000 note due to the bank and a \$10,000,000 note due to Cerro; both notes are due April 1, 1977. These notes bear interest at 1 1/4% above the bank's alternate base rate (a rate which approximates the prime rate), two percent (2%) of such interest on the bank's note was payable monthly in cash and the difference between 2% and 1 1/4% over the bank's alternate base rate was due at maturity. The loan agreement was principally secured by the assignment of notes, mortgages, deeds of trust, the Company's interest in its joint ventures, the Company's rights to cash distributions per certain agreements, and first mortgages on most of the Company's unencumbered real estate. The loan agreement also required the maintenance of minimum tangible net worth and limitations on the purchase and sale of certain assets, which, if not met, could be deemed events of default by the bank. At December 31, 1975, the Company was not in compliance with all the requirements of the agreement. On March 11, 1976, the agreement was amended to eliminate all such existing events of default.

In connection with an amendment of the loan agreement, on June 18, 1975, Cerro purchased the utility system formerly operated by the Company for an aggregate purchase price of approximately \$15,750,000, of which \$12,000,000 was paid in cash and the balance of \$3,750,000 was paid by issuance of a Cerro note, payable \$93,750 quarterly plus interest at the bank's Alternate Base Rate until October 1, 1980 when the final payment of \$1,875,000 is due.

On February 22, 1977 the Company and the bank agreed to an exchange of assets for the cancellation of the loan agreement as of December 31, 1976. The terms of the exchange were as follows: (1) the Company paid the bank approximately \$22,105,000 in cash, (2) transferred a note receivable from Cerro secured by the utility system with a principal balance of approximately \$3,188,000 to the bank, (3) issued to the bank mortgages secured by real estate totaling approximately \$4,474,000 and (4) issued to the bank an unsecured note payable guaranteed by Cerro of \$12,000,000 in exchange for the forgiveness of the outstanding principal, approximately \$42,444,000, and the outstanding interest payable of approximately \$5,078,000. In connection with the exchange the Company sold approximately \$13,796,000 of notes receivable and issued a new note payable of \$6,242,000 secured by certain net trust deeds receivable for approximately \$20,038,000 to a third party and approximately \$1,063,000 of second trust deeds to The Housing Group. In addition Cerro advanced the Company approximately \$1,004,000 to pay the bank.

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The gain on the extinguishment of debt included in the quasi-reorganization (Note 2) is as follows (in thousands):

Interest forgiven	\$5,078
Principal forgiven	678
Imputed interest on new notes payable	2,766
Loss on notes receivable sold	( 43)
Expenses	( 203)
	<u>\$8,276</u>

The \$12,000,000 note payable to the bank is due in four annual instalments of \$3,000,000 and is non-interest bearing. This note has been discounted at ten percent (10%) for a total discount of \$2,490,000.

(b) The Company has additional notes payable secured by multi-family projects, which amounts have been deducted from notes receivable secured by all-inclusive trust deeds on those projects. The principal remedy in the event of default, under such notes, is recourse solely against the property secured thereby through a trustee's sale under provisions of the trust deed. In relatively rare instances, the statutory provisions allowing a deficiency judgment to be obtained through judicial processes are utilized in lieu of the rights under the sale provision of the trust deed. Such judicial processes are rarely used by lenders inasmuch as they may take several years and are subject to a right of redemption by the property owner following a judgment.

Notes payable mature in varying instalments; however, acceleration of payments may be required to release mortgaged property sold. Notes payable maturing by their terms are due as follows after giving effect to the loan cancellation described above:  
1977 - \$12,987,000; 1978 - \$4,137,000; 1979 - \$8,555,000;  
1980 - \$3,386,000; 1981 - \$3,617,000; thereafter - \$12,965,000.

#### NOTE 9 - Income Taxes:

The credit in lieu of income taxes for the year ended December 31, 1975 consists of the amortization of net deferred tax credits for federal income taxes of \$1,170,000.

Deferred taxes result from timing differences in the recognition of revenues and expenses for financial statement and tax purposes.

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The Company's taxable income (loss) is included in the consolidated federal income tax return of Cerro. The Company has a tax sharing agreement with Cerro, which has the following significant provisions: (1) the Company's credit or provision for income taxes for financial statement and tax purposes is computed as if the Company were filing separate consolidated tax returns and made such elections that would result in the lowest possible tax liability to the Company, (2) any payments or refunds based upon the above computations, under certain circumstances, are subject to a 15% reduction and (3) any refunds resulting from losses generated by the Company are not refundable to the Company until the losses are utilized by Cerro for tax purposes. Cerro elections for tax purposes differ in certain instances from those used by the Company.

Investment tax credits are accounted for on the "flow-through" method and are immaterial.

As a result of the quasi-reorganization described in Note 2, the tax benefits of loss carryforwards arising prior to the quasi-reorganization will be added to additional paid-in capital, if realized in subsequent years. At December 31, 1976 the Company has operating losses on a separate Company basis for income tax purposes of \$34,800,000 and additional operating losses of \$3,600,000 for financial statement purposes, which will be available when incurred for tax purposes; these operating losses expire as follows (in thousands):

<u>Expires December 31,</u>	<u>Tax Losses</u>
1978	\$10,100
1979	15,500
1982	2,100
1983	7,100

The Internal Revenue Service is examining the consolidated income tax returns of the Company for the three years ended December 31, 1974 in connection with an examination of Cerro; however, no report has been received.

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NOTE 10 - Due to Parent Company:

The amounts due to (from) Cerro at December 31, 1976 and 1975 are as follows (in thousands):

	<u>1976</u>	<u>1975</u>
Unsecured advances at prime interest rate plus 4%	\$ 5,872	\$ 7,500
Notes payable at prime interest rate plus 1 1/4% secured under the terms of the bank revolving and term loan agreement (Note 8)	5,000	5,000
Note payable to Cerro due April 1, 1977 for participation in bank revolving and term loan agreement (Note 8)	9,898	7,675
Accrued interest payable (Note 2)	4,578 (1) 559	2,618 319
Open account, net Receivable for federal income taxes	( 3,421)	( 3,421)
Notes receivable secured by utility system (Note 8)	( 3,188)	( 3,656)
	<u>\$19,298</u>	<u>\$16,035</u>

- (1) As described in Note 2, Cerro contributed to the Company \$4,449,000 of this amount as a capital contribution in the quasi-reorganization.

Interest charged by Cerro for the years ended December 31, 1976 and December 31, 1975 amounted to \$2,066,000 and \$1,746,000, respectively of which \$1,662,000 and \$1,259,000, respectively was expensed in the statement of operations and the balance was capitalized to inventories.

NOTE 11 - Stockholder's Equity:

The authorized stock of the Company consists of (1) 150,000 shares of Series A preferred stock, \$100 par value, \$6.25 cumulative dividend per share of which 116,950 shares have been issued to Cerro and (2) 1,000 shares of common stock, no par value, which have been issued to Cerro.

As of December 31, 1976 no dividends have been declared or paid and approximately \$2,008,000 of cumulative preferred dividends were in arrears.

In connection with the acquisition of 100% of the common stock of the Company by Cerro in 1973 and the subsequent transfer by Cerro to the Company of its wholly owned subsidiary, Richmar Development Corporation, the Company terminated all outstanding stock

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options and warrants. The termination agreements provided for cash payments to the option and warrant holders providing certain conditions, including continued employment, were complied with. Based on an understanding with Cerro, all payments under the termination agreements through December 31, 1974 were funded by Cerro.

During 1975 substantially all rights to receive payments by the remaining option and warrant holders under the termination agreements became vested and a charge in the amount of \$1,040,000 for the present value of such payments has been included in the statement of operations. Cerro funded such payments in the form of capital contributions.

See Note 2 for an analysis of changes in additional paid-in capital.

NOTE 12 - Commitments and Contingencies:

The Company is liable for obligations in the normal course of business for the completion of contracts relating to construction of houses, purchases of land, improvements of property sold and guarantees to purchasers of apartment projects.

The Company is involved in pending and threatened litigation relating to existing and potential claims, principally related to the guarantees to purchasers of apartment projects and sales of single family residences. The outcome of the litigation is uncertain, but based on information currently available it is probable that losses have been incurred. The Company cannot estimate the exact amount of such losses, but its reasonable estimate is that the losses will not be less than \$1,300,000. In accordance with Financial Accounting Standards No. 5 the Company has provided this amount in the statement of operations (General and administrative expenses) prior to the quasi-reorganization. See Note 2 for additional losses provided for in the quasi-reorganization.

During 1976 the Company subleased certain office space to The Housing Group in a building in which the Company has a long term lease. As a result substantially all of the office space is leased to The Housing Group and independent third parties at rates which are lower than the Company's lease rate. Accordingly, the Company has provided for the estimated losses to be sustained over the term of the lease discounted at 10% which resulted in a charge to operations (General and administrative expenses) of approximately \$900,000.

As described in Note 3, the Company sold land to the Pritzker Trusts, which the Company was required to repurchase and had an option to repurchase additional land at a repurchase price consisting of the Company's selling price to the Trusts, the Trusts' development and carrying costs and a specified premium.

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In addition the Company was entitled to 50% of the profits, as defined, on resale of other land not subject to the repurchase obligation or option.

On February 22, 1977 the Company and the Trusts agreed to cancel each other's rights and obligations in connection with the repurchase and other related agreements described in the preceding paragraph. Under the terms of the cancellation agreement the purchase money second mortgage was modified with respect to payment terms, such that the ultimate collectibility cannot be determined and therefore the mortgage note receivable will not be recorded on the books of the Company in 1977 (Note 3). The cancellation agreement has been given effect to in the quasi-reorganization and the sale will be recorded in 1977 at an amount equivalent to the cash previously received.

The Company is a participant with the Pritzker Trusts (Note 6) in two joint ventures. While the Company has no investment in these particular ventures, it is contingently liable to lenders for approximately \$19,200,000 of notes payable by the joint ventures. The Company, however, would have recourse to the joint ventures. At December 31, 1976 approximately \$18,200,000 of such debt of one of the joint ventures was in default and actions for foreclosures and deficiency judgements had been filed by the note holders. It cannot be determined at this time whether a loss related to this contingency is probable and no provision has been recorded in the financial statements as of December 31, 1976 for any such loss that may result on resolution of this contingency.

NOTE 13 - Interest Capitalization:

It has been the Company's historical practice to capitalize interest relating to obligations incurred in connection with land, construction and land improvements. Had the Company followed the policy of expensing all interest as incurred, the net loss would have been as follows (in thousands):

	<u>Net loss</u>
Year ended December 31:	
1976	\$20,035
1975	36,393

Interest applicable to other obligations including the revolving and term loan agreement has been expensed as incurred.

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LEADERSHIP HOUSING, INC.  
SCHEDULE II - AMOUNTS RECEIVABLE FROM DIRECTORS, OFFICERS AND EMPLOYEES  
FOR THE YEARS ENDED DECEMBER 31, 1976 AND 1975

(In Thousands)

<u>Col. A</u>	<u>Col. B</u>	<u>Col. C</u>	<u>Col. D</u>	<u>Col. E</u>
<u>Name of Debtor</u>	<u>Balance at beginning of period</u>	<u>Additions</u>	<u>Deductions Collected Other</u>	<u>Balance at Current non-current</u>
1976				
Accounts receivable - other				
Directors, officers and employees				
R. E. Fritts	<u>\$22</u>		<u>(\$22)(1)</u>	
1975				
R. E. Fritts	<u>-</u>	<u>\$22</u>		<u>\$22</u>

(1) Bears interest at 6%, due June 7, 1977, Mr. Fritts is no longer an officer of Leadership Housing, Inc.

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**LEADERSHIP HOUSING, INC.**  
**SCHEDULE V - PROPERTY, PLANT AND EQUIPMENT**  
**FOR THE YEARS ENDED DECEMBER 31, 1976 AND 1975**  
**(\$ in Thousands)**

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F	
					Before	After
Classification	Balance at Beginning of Period	Additions at Cost Acquisitions	Retirements	Other Changes (1)	Balance at End of Period	Adjustments Resulting from Quasi-reorganization of Peril.
1976:						
Land and land improvements	\$ 1,078		(\$ 89)	\$ 52	\$1,041	\$ 997
Buildings and structures	193		( 136)	( 1)	56	48
Utility system						
Machinery and equipment	955	\$ 23	( 218)	( 77)	683	22
Golf courses and related facilities	<u>2,493</u>	<u>29</u>		<u>2,401</u>	<u>4,923</u>	<u>3,833</u>
	<u>\$ 4,719</u>	<u>\$ 52</u>	<u>(\$ 443)</u>	<u>\$ 2,375</u>	<u>\$6,703</u>	<u>\$4,900</u>
1975:						
Land and land improvements	\$ 1,359		(\$ 261)	(\$ 20)	\$1,078	
Buildings and structures	994	\$ 1	( 711)	( 91)	193	
Utility	15,060	436		( 15,496)		
Machinery and equipment	1,266	30	( 509)	168	955	
Golf courses and related facilities	<u>1,042</u>	<u>65</u>		<u>1,386</u>	<u>2,493</u>	
	<u>\$19,721</u>	<u>\$532</u>	<u>(\$1,481)</u>	<u>(\$14,053)</u>	<u>\$4,719</u>	

(1) Principally the sale of Tamarac Utilities, Inc. to Cerro Corporation in 1975.

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LEADERSHIP HOUSING, INC.  
SCHEDULE VI - ACCUMULATED DEPRECIATION AND AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT  
FOR THE YEARS ENDED DECEMBER 31, 1976 AND 1975

Col. A	Col. B	(\$ In Thousands)		Col. D	Col. E	Col. F	
		Col. C	Col. E			Before	After
		Additions				Quasi-reorganization	Adjustments
	Balance at beginning of period	Acquisitions	Charged to costs and expenses	Retirements	Other charges (1)	Balance at end of period	quasi-reorganization of period
Land and land improvements	\$ 14		\$ 1		\$ 1	\$ 16	(\$ 16)
Buildings and structures	55		3	(\$ 20)	( 23)	15	15
Utility system	-						
Machinery and equipment	517		114	( 76)	( 18)	537	( 526)
Golf courses and related facilities	40		48		1	89	40
	<u>\$ 626</u>		<u>\$166</u>	<u>(\$ 96)</u>	<u>(\$ 32)</u>	<u>\$657</u>	<u>(\$502)</u>
Land and land improvements	\$ 9		\$ 8	(\$ 3)		\$ 14	
Buildings and structures	142		26	( 97)	( 16)	55	
Utility system	970		172		( 1,142)	-	
Machinery and equipment	643		135	( 285)	24	517	
Golf courses and related facilities	6		32		2	40	
	<u>\$1,770</u>		<u>\$373</u>	<u>(\$385)</u>	<u>(\$1,132)</u>	<u>\$626</u>	

(1) Principally the sale of Tamarac Utilities, Inc. to Cerro Corporation in 1975.

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LEADERSHIP HOUSING, INC.

SCHEDULE XII - VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

FOR THE YEARS ENDED DECEMBER 31, 1976 AND 1975

(\$ In Thousands)

<u>Col. A</u>	<u>Col. B</u> Balance at beginning of period	<u>Col. C</u> Additions	<u>Col. D</u> Deductions	<u>Col. E</u> Balance at end of period
1976				
Current trade receivables	\$406	\$96	(\$156)(1)	\$346
1975				
Current trade receivables	\$833	\$256	(\$683)(1)	\$406

(1) Uncollectible accounts written off net of recoveries.

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LEADERSHIP HOUSING, INC.

SCHEDULE XVI - SUPPLEMENTARY INFORMATION TO STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED DECEMBER 31, 1976 AND 1975  
(\$ In Thousands)

<u>Col. A</u>	<u>Year ended December 31,</u>	
	<u>1976</u>	<u>1975</u>
Property taxes (1)	\$420	\$601
Other taxes excluding income taxes	139	259
Advertising	310	1,174
Maintenance and repairs	306	597
Rents, net of sublease revenues of \$271 and \$146	258	634
Depreciation of property, plant and equipment	166	373

NOTE: Amortization of intangibles was not significant in amount.

- (1) Above amounts represent the total expensed by the Company through cost of sales and general and administrative expenses. Additional property taxes are capitalized to inventories and will be charged to cost of sales when the related properties are sold.

LS 000778



**Kenneth Leventhal & Company**

Certified Public Accountants

660 Newport Center Drive  
Newport Beach, California 92660  
(714) 640-5000

**Board of Directors  
The Housing Group**

We have examined the consolidated balance sheet of The Housing Group as of December 31, 1976 and the related consolidated statement of income and retained earnings and consolidated statement of changes in financial position for the nine months then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of The Housing Group at December 31, 1976 and the consolidated results of its operations and the changes in its consolidated financial position for the nine months then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

*Kenneth Leventhal & Company*

March 7, 1977

LS 000779

Kenneth Leventhal & Company

Certified Public Accountants

1401 Brickell Avenue

Miami, Florida 33131

(305) 358-5733

Board of Directors  
The Communities Group, Inc. of Broward County  
Ft. Lauderdale, Florida

We have examined the consolidated balance sheet of The Communities Group, Inc. of Broward County as of December 31, 1976 and the related consolidated statements of income and changes in financial position for the three months then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements (which are not presented separately in this annual report on Form 10K) present fairly the consolidated financial position of The Communities Group, Inc. of Broward County as of December 31, 1976 and the consolidated results of its operations and changes in its financial position for the three months then ended in conformity with generally accepted accounting principles.

*Kenneth Leventhal & Company*

KENNETH LEVENTHAL & COMPANY

March 2, 1977

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ARTHUR ANDERSEN & Co.

CERTIFIED PUBLIC ACCOUNTANTS

MIAMI, FLORIDA 33131

To the Partners of  
Boca Del Mar Associates and  
Boca Del Mar Golf and Tennis Club:

We have examined the combined balance sheet of Boca Del Mar Associates (a partnership) and Boca Del Mar Golf and Tennis Club (a partnership) as of December 31, 1976, and the related combined statements of operations, partners' equity and sources and uses of cash for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above (not separately presented herein) present fairly the combined financial position of Boca Del Mar Associates and Boca Del Mar Golf and Tennis Club as of December 31, 1976, and the results of their operations and sources and uses of cash for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

*Arthur Andersen & Co.*

Miami, Florida,  
January 21, 1977.

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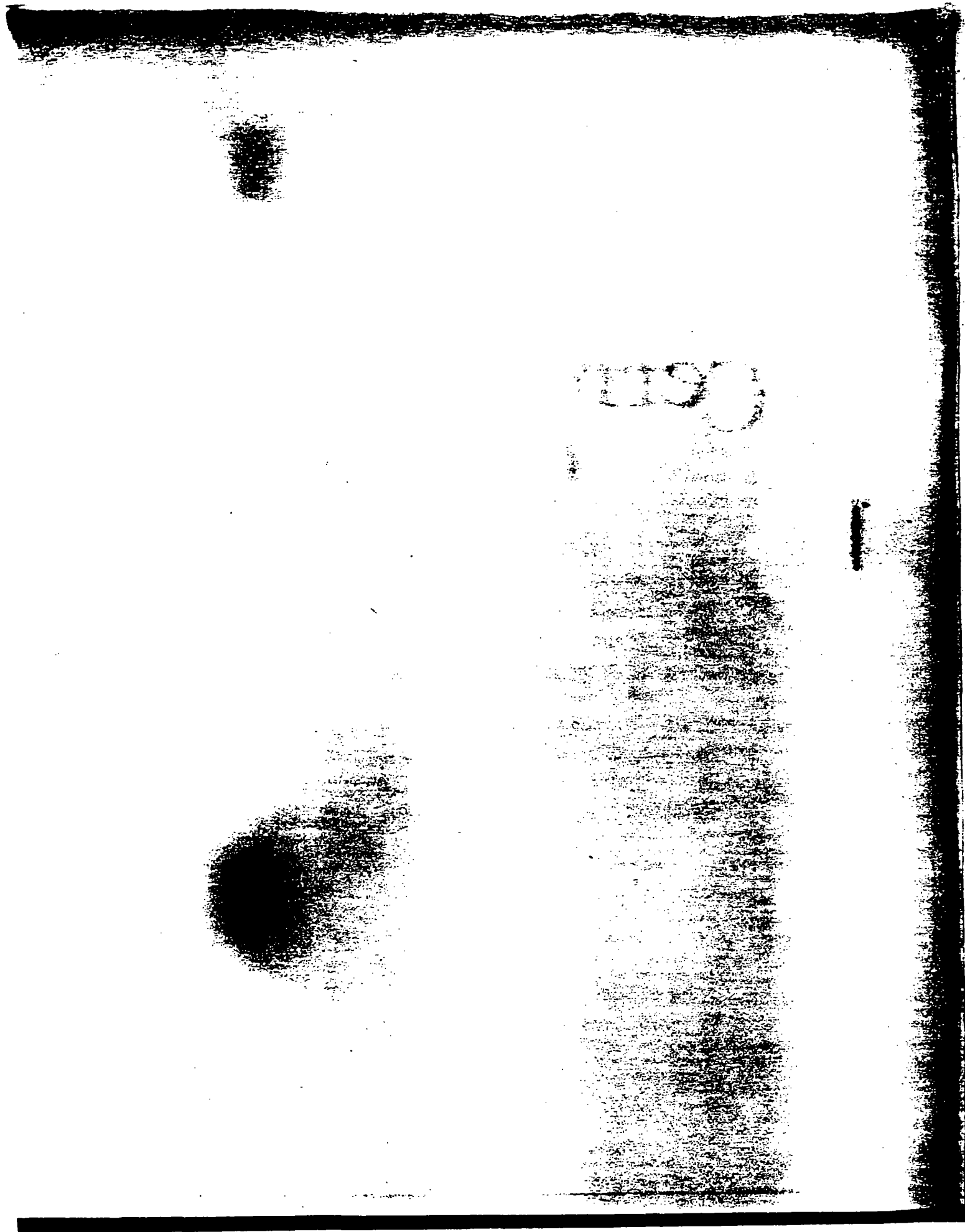
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Annual Report 1976  
Cerro-Marmion  
Corporation

LS 000784





CERRO-MARMON CORPORATION  
1976 ANNUAL REPORT TO SHAREHOLDERS

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To our shareholders:

The year 1976 was a profitable one for Cerro-Marmon Corporation. On a pro forma basis sales were \$908,390,000 and net income amounted to \$45,210,000.

The enclosed financial statements reflect the merger of Cerro Corporation into Cerro-Marmon on February 24, 1976. This business combination has been accounted for as a purchase of Cerro by Cerro-Marmon. For a more complete understanding of these statements we suggest you thoroughly review Notes 1 and 2 under the heading "Notes to Consolidated Financial Statements" beginning on page 12 of this annual report.

In January 1977, Cerro-Marmon acquired all of the outstanding shares of Hammond Corporation. Hammond produces electric organs as well as a line of work and dress gloves. To accomplish this acquisition, GL Corporation contributed 1,648,984 shares of Hammond common stock which it acquired prior to May 1974 at a cost of \$15,933,000. The balance of Hammond's outstanding capital stock was acquired in a cash merger at a cost of \$17,611,000 and Hammond became a wholly-owned subsidiary of Cerro-Marmon.

During 1976, Cerro-Marmon divested itself of a number of operations in line with present management's philosophy of building Cerro-Marmon primarily on its base in metal manufacturing and coal mining. Investments sold were the Zidani Asbestos Mine Project in Greece, the Cerro Spar joint venture mining properties in Kentucky and Tennessee and Northwest Iron Co., Ltd. in Australia.

In 1976 a decision was made to sell the ICX trucking operation. Negotiations have been concluded to sell ICX to a newly created corporation owned by certain ICX salaried employees. Cerro-Marmon will own a 19% interest in the new corporation.

Early in 1977, the debt of Leadership Housing was restructured and certain agreements were modified. As a result, Leadership has become a viable entity that Cerro-Marmon can support financially during the period required for an orderly disposition of certain land inventories and continued operation of the balance.

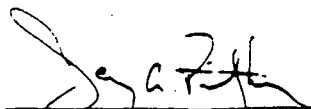
Home office functions were consolidated in the move of the Cerro office from New York to Chicago. Total home office expenses were reduced from \$4,900,000 in 1975 to \$3,000,000 in 1976. This is in accordance with our philosophy of operating with minimum home office overhead and expenses.

We feel that through divestitures, realignments and reorganizations, Cerro-Marmon is now a simpler, more manageable organization which should continue to grow and prosper in the coming year.

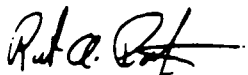
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We would be remiss if we did not take advantage of this opportunity to comment on the high quality of personnel we have found at the various Cerro operating units. We want to thank them and the Marmon people for bearing with us during the difficult times which, it is hoped, are now behind us.



Jay A. Pritzker  
Chairman of the Board



Robert A. Pritzker  
President

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## GENERAL INFORMATION

### Stock Information

Cerro-Marmon's \$2.25 Cumulative Series A Preferred Stock was listed for trading on the American Stock Exchange on February 24, 1976. Sales prices on the American Stock Exchange and dividends paid since February 24, 1976 are as follows:

	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
Sales prices:				
High	\$ 20.38	\$ 21.50	\$ 22.25	\$ 23.63
Low	18.88	19.25	20.00	21.50
Dividends	\$.2227	\$.5625	\$.5625	\$.5625

### Stock transfer agent

Irving Trust Company  
One Wall Street  
New York, New York 10015  
(212) 487-5742

### Registrar of stock

Bankers Trust Company  
P.O. Box 318  
Church Street Station, New York 10015

### Auditors

Arthur Young & Company  
One IBM Plaza  
Chicago, Illinois 60611

### Annual shareholders' meeting

The annual meeting of Cerro-Marmon Corporation will be held at 10:30 a.m. on June 3, 1977  
at the Water Tower Hyatt House, 800 N. Michigan Avenue, Chicago, Illinois  
Room Promenade A.

### Form 10-K

A copy of the annual report to the Securities and Exchange Commission on Form 10-K may be  
obtained from the company at no expense to the shareholder. Direct your request to:

Mr. Thomas L. Seifert, Secretary  
Cerro-Marmon Corporation  
39 South LaSalle Street  
Chicago, Illinois 60603

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## BUSINESS DESCRIPTION

Cerro-Marmon Corporation (Cerro-Marmon) was incorporated in Delaware on November 25, 1975 and was inactive until February 24, 1976. On that date, Cerro Corporation (Cerro) merged into Cerro-Marmon pursuant to a Plan of Merger and an Exchange Agreement, each dated January 15, 1976. Pursuant thereto, GL Corporation (GL), a Delaware corporation, exchanged all of the outstanding shares of capital stock of The Marmon Group, Inc. (Michigan) (Marmon) for five million newly issued common shares of Cerro-Marmon.

The former Cerro operations are engaged in the United States in the manufacture and sale of refined copper, copper and brass mill products, electric wire and cable and valves, fittings, regulators and other control equipment for pressurized gases; coal mining; the holding of real estate for sale or development; and common carrier motor freight operations which are to be sold. A wholly-owned subsidiary conducts world wide trading activities in nonferrous refined metals, concentrates and ores including copper, lead, zinc, silver and companion metals. Cerro-Marmon also has a 21.02% interest in Southern Peru Copper Corporation, a company which operates large copper mines in Peru, and various interests in several relatively small mining and manufacturing companies in Peru.

Marmon is a wholly-owned subsidiary of Cerro-Marmon. Marmon was organized on August 26, 1969, and is the successor through merger to a corporation which was organized in 1904. Marmon is engaged, directly and through several subsidiaries, in the distribution of steel pipe and tubing and the manufacture and fabrication of copper and aluminum tubing; the manufacture of products for use principally in the automotive industry; the design and manufacture of equipment used in the mining industry; the manufacture of building products and equipment; and the manufacture of specialized equipment for use principally in the agricultural industry.

Reference is made to the lines of business and pro forma lines of business data which appears on pages 34, 35, 36 and 37 of this report and to Management's Discussion and Analysis of Results of Operations appearing on pages 38 and 39 for more information on the combined results of operations of Cerro-Marmon.

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## REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Shareholders  
Cerro-Marmon Corporation

We have examined the consolidated balance sheets of Cerro-Marmon Corporation (Note 1) at December 31, 1976 and 1975 and the related consolidated statements of income, shareholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have received the reports of other independent accountants on their examinations of the 1976 consolidated financial statements of the trucking subsidiary (Note 8) and the major real estate subsidiary (Leadership) (Note 9). Our opinion expressed herein on the 1976 consolidated financial statements of Cerro-Marmon, insofar as it relates to amounts included in such consolidated financial statements that were derived from the 1976 consolidated financial statements of the trucking subsidiary and Leadership, is based solely on the reports of the other independent accountants.

The report of other independent accountants referred to above on the 1976 consolidated financial statements of Leadership and our report dated April 9, 1976 on the 1975 consolidated financial statements of The Marmon Group, Inc. (Michigan) (the accounting predecessor of Cerro-Marmon) were qualified as to the effects of such adjustments, if any, as might have been required had the outcome of certain specified uncertainties relating to the real estate operations been known. As discussed in Note 3, the partial resolution of these uncertainties in 1976 did not have a material effect upon the accompanying consolidated financial statements of Cerro-Marmon at December 31, 1976 and 1975 and for the years then ended and the resolution of the remaining uncertainties relating to the real estate operations will not have a material effect on such financial statements. Accordingly, our present opinion on the 1975 financial statements, as presented herein, is different from that expressed in our previous report.

As discussed in Note 3 to the consolidated financial statements, the allocation of purchase cost reflected in the consolidated balance sheet at December 31, 1976 and the effects thereof reflected in the consolidated statements of income for 1976 and 1975 are subject to retroactive revision to reflect (1) the realization of income tax benefits from prior year losses of Cerro and (2) the outcome of certain specific matters discussed in Note 3 relating to Leadership and the prior year federal income tax position of Cerro. The effect of such retroactive revisions, if any, cannot be determined at this time. However, as discussed in Note 3 to the consolidated financial statements, any retroactive revisions required will not have a material effect on the 1975 consolidated financial statements or on consolidated working capital and shareholders' equity at

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December 31, 1976, nor will the effects of any such adjustments exceed 10% of reported consolidated net income for 1976.

In our opinion, based on our examinations and the reports of other independent accountants referred to in the first paragraph above, and subject to the effects on the 1976 consolidated financial statements of such retroactive revisions, if any, as may be required to reflect the outcome of the matters referred to in the preceding paragraph, the statements described in the first paragraph above present fairly the consolidated financial position of Cerro-Marmon Corporation at December 31, 1976 and 1975 and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR YOUNG & COMPANY

Chicago, Illinois

April 22, 1977

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CERRO-MARCON CORPORATION

CONSOLIDATED BALANCE SHEET

(In thousands of dollars)

**ASSETS**

	December 31,	
	1976	1975
	(Notes 1, 2 and 3)	(Notes 1, 2 and 3)
Current assets:		
Cash	\$ 3,610	\$ 1,983
Time and certificates of deposit (Note 6)	58,243	133
Marketable securities (Note 4)	12,939	
Receivables -		
Trade accounts, less allowances of \$2,629 in 1976 and \$1,464 in 1975	97,997	37,841
Chile (Note 5)	5,473	2,666
Refundable income taxes (Note 15)	4,597	1,715
Other	8,985	50,781
Inventories (Note 4 and 6)	202,120	7,138
Other current assets	7,138	1,767
Total current assets	401,102	96,886
Investments in and advances to:		
Cerro Corporation (Note 7)	17,009	78,896
Trucking subsidiary (Note 8)	20,035	
Real estate subsidiaries (Note 9)	7,650	1,569
Other (Note 10)		
Notes due from Chile (Note 5)	3,064	
Property, plant and equipment - net (Note 11)	100,092	36,221
Other assets	8,564	5,094
	<u>\$557,516</u>	<u>\$218,666</u>

**LIABILITIES AND SHAREHOLDERS' EQUITY**

	December 31,	
	1976	1975
	(Notes 1, 2 and 3)	(Notes 1, 2 and 3)
Current liabilities:		
Notes payable (Note 12) -		
Banks	\$ 39,480	\$ 2,000
Affiliates	3,000	
Long-term obligations due within one year (Note 12)	11,800	4,886
Accounts payable (Note 6)	96,822	15,307
Income taxes (Note 15)	21,475	1,792
Accrued liabilities (Note 13)	33,531	10,611
Total current liabilities	206,108	34,596
Long-term obligations (Note 12)	97,439	81,400
Deferred credit from acquisition (Note 3)	11,454	
Other non-current amounts	15,418	1,784
Contingencies (Notes 8, 10, 14 and 16)		
Shareholders' equity (Notes 12 and 17):		
Preferred stock, liquidation preference and redemption value of \$93,699	89,248	
Common stock	5,000	1
Other paid-in capital	10,241	12,027
Retained earnings	122,608	88,850
Total shareholders' equity	227,097	100,886
	<u>\$557,516</u>	<u>\$218,666</u>

See Notes to Consolidated Financial Statements.

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CERRO-MARMON CORPORATION  
CONSOLIDATED STATEMENT OF INCOME

(In thousands of dollars)

	Years ended December 31,	
	1976	1975
	(Notes 1, 2 and 3)	
Revenues:		
Net sales	\$828,218	\$275,536
Miscellaneous - net (Note 10)	10,927	1,572
	<u>839,145</u>	<u>277,108</u>
Costs and expenses:		
Cost of sales	703,515	217,790
Selling and administrative	58,455	26,580
Interest	11,342	8,024
	<u>773,312</u>	<u>252,394</u>
Income before amounts shown below	65,833	24,714
Income taxes (Note 15)	<u>28,050</u>	<u>12,855</u>
Income before equity in net income of Cerro Corporation and discontinued business	37,783	11,859
Equity in net income from continuing operations of Cerro Corporation (Note 7)	<u>1,436</u>	<u>10,384</u>
Income from continuing operations	39,219	22,243
Income of discontinued business less income taxes (Note 8)	<u>3,540</u>	<u>2,460</u>
Net income	42,759	24,703
Net income applicable to preferred stock (Note 17)	<u>(9,009)</u>	
Net income applicable to common stock	<u>\$ 33,750</u>	<u>\$ 24,703</u>

See Notes to Consolidated Financial Statements.

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CERRO-MARMON CORPORATION  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
YEARS ENDED DECEMBER 31, 1976 AND 1975  
(In thousands of dollars)

	Preferred Stock (Note 17)	Common Stock (Note 17)	Other Paid-In Capital	Retained Earnings (Note 12)	Total
Balance at January 1, 1975	\$	1	\$ 11,962	\$ 64,590	\$ 76,553
Net income				24,703	24,703
Other - net			65	(435)	(370)
Balance at December 31, 1975		1	12,027	88,858	100,886
Excess of par value of Cerro-Marmon common stock issued to GL over par value of Marmon common stock		4,999	(4,999)		
Value of preferred stock issued and issuable to Cerro shareholders (Note 2)	88,375				88,375
Contribution by GL (Note 16)			2,336		2,336
Elimination of Marmon deferred income taxes applicable to its equity in undistributed net income of Cerro			877		877
Preferred dividends paid				(8,136)	(8,136)
Accrual of redemption value of preferred stock (Note 17)	873			(873)	
Net income				42,759	42,759
Balance at December 31, 1976	\$ 89,248	\$ 5,000	\$ 10,241	\$ 122,608	\$ 227,097

See Notes to Consolidated Financial Statements.

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CERRO-MARMON CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(In thousands of dollars)

	Years ended December 31,	
	<u>1976</u>	<u>1975</u>
Sources of working capital:		
Income from continuing operations	\$ 39,219	\$ 22,243
Charges (credits) not involving working capital -		
Provision in lieu of income taxes	6,030	65
Depreciation, depletion and amortization	9,460	5,386
Equity in undistributed net income from continuing operations of Cerro Corporation	(786)	(6,271)
Other - net	2,276	739
Total from continuing operations	<u>56,199</u>	<u>22,162</u>
Income of discontinued business - net	3,540	2,460
Charge (credits) not involving working capital -		
Provision in lieu of income taxes	1,367	
Equity in undistributed net income of discontinued business	(2,886)	(2,460)
Total from discontinued operations	<u>2,021</u>	<u>2,460</u>
Total from operations	<u>58,220</u>	<u>22,162</u>
Merger of Cerro Corporation at February 24, 1976 -		
Preferred stock issued and issuable	\$ 88,375	
Marmon's basis in 45.33% of Cerro	80,028	
Long-term obligations assumed	84,104	
Other - net	18,248	
	<u>270,755</u>	
Less cost assigned to non-current assets:		
Trucking subsidiary	14,444	
Real estate subsidiaries	14,944	
Notes due from Chile	15,087	
Property, plant and equipment - net	59,438	
Other non-current assets	4,507	
	<u>108,420</u>	
Total from merger of Cerro Corporation	162,335	
Reduction in long-term portion of notes due from Chile	12,669	
Long-term borrowings	8,160	1,900
Sale of investments	1,369	
Disposition of property, plant and equipment	<u>3,764</u>	<u>1,771</u>
Total	<u>246,517</u>	<u>25,833</u>

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## Disposition of working capital:

Investment in Southern Peru Copper Corporation	5,450	
Additional investment in and advances to real estate subsidiaries - net	5,091	
Purchase of property, plant and equipment	17,657	7,245
Reduction in long-term obligations	76,513	5,106
Preferred dividends paid	8,136	
Other - net	966	(410)
Total	<u>113,813</u>	<u>11,941</u>
Increase in working capital	<u>\$132,704</u>	<u>\$ 13,892</u>

## Changes in Elements of Working Capital

## Increase (decrease) in current assets:

Cash, deposits and marketable securities	\$ 72,676	\$ 1,657
Receivables	74,830	979
Inventories	151,339	(4,317)
Other current assets	5,371	(237)
	<u>304,216</u>	<u>(1,918)</u>

## (Increase) decrease in current liabilities:

Notes payable to banks	(37,480)	8,000
Notes payable to affiliates	(3,000)	
Long-term obligations due within one year	(6,914)	(3,189)
Accounts payable	(81,515)	9,974
Income taxes	(19,683)	519
Accrued liabilities	<u>(22,920)</u>	<u>506</u>

Increase in working capital	<u>\$132,704</u>	<u>\$ 13,892</u>
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See Notes to Consolidated Financial Statements.

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# CERRO-MARMON CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1976 and 1975

(Tabular amounts are in thousands of dollars, except as noted)

### 1. Organization and Basis of the Financial Statements

Cerro-Marmon Corporation (Cerro-Marmon), incorporated on November 25, 1975, was inactive until February 24, 1976. On that date (1) Cerro-Marmon issued 5 million common shares to GL Corporation (GL) for all of the outstanding common shares of The Marmon Group, Inc. (Michigan) (Marmon), in a transaction accounted for as if it was a pooling of interests, (2) Cerro-Marmon became obligated to issue preferred stock to holders of Cerro Corporation (Cerro) common stock, other than Marmon, on a share-for-share basis and (3) Cerro was merged into Cerro-Marmon in a transaction accounted for as a purchase. Cerro common stock owned by Marmon, representing 45.33% of the Cerro common stock outstanding, was cancelled. As a result of the above described transactions, GL owns 100% of the outstanding Cerro-Marmon common stock, which represents approximately 82% of the total voting interest in Cerro-Marmon, and Marmon is a wholly-owned subsidiary of Cerro-Marmon.

The consolidated financial statements for periods prior to February 25, 1976 consist of the consolidated financial statements of Marmon (Cerro-Marmon's accounting predecessor company) and all subsidiaries, with Marmon's 45.33% interest in Cerro accounted for on an equity basis. Commencing February 25, 1976, the consolidated financial statements consist of the financial statements of Cerro-Marmon and all significant subsidiaries except the real estate subsidiaries (Notes 2 and 9) and the trucking subsidiary which is to be sold (Note 8).

### 2. Acquisition of Cerro

Effective August 1, 1974, Marmon acquired 3,586,297 common shares of Cerro, a 45.33% equity interest, at a total cost of \$67,846,000. Of the shares acquired, 813,100 shares were acquired from GL at GL's cost of \$14,031,000 and the remaining shares were acquired pursuant to a cash tender offer. The shares acquired from GL were purchased by GL principally in the period February-May 1974.

On February 24, 1976, Cerro was merged into Cerro-Marmon (Note 1). Pursuant thereto, the former common shareholders of Cerro, other than Marmon, became entitled to receive one share of Cerro-Marmon \$2.25 Cumulative Series A Preferred Stock (Note 17) for each share of Cerro common stock. Accordingly, the holders of a total of 4,324,970 common shares of Cerro were entitled to receive a like number of preferred shares. Of this number of shares, shareholders owning 65,913 shares have received or will receive cash for their shares. The preferred shares were valued by the Board of Directors of Cerro-Marmon at \$20.75 per share, based on the estimated fair value of the preferred stock determined when the exchange ratio was approved by the Board of Directors of Cerro. A value of \$19 per share has been assigned to the Cerro shares to be acquired for cash (Notes 16 and 17).

The above described transactions have been accounted for as a purchase of Cerro by Cerro-Marmon. Accordingly, the net assets of the businesses formerly conducted by Cerro are included in the consolidated balance sheet of Cerro-Marmon at amounts determined after giving effect to an allocation of Cerro-Marmon's purchase cost to such net assets.

The amount at which Cerro's net assets at February 24, 1976 were included in the Cerro-Marmon balance sheet at that date was determined as follows:

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Applicable to 45.33% interest -

Cost to Marmon	\$ 67,846
Equity in Cerro's undistributed net income	<u>12,182</u>
Marmon's basis in 45.33% of Cerro at February 24, 1976	\$ 80,028

Applicable to 54.67% interest -

Value of preferred stock issuable	88,375
Cerro common stock to be acquired for cash	1,253
Acquisition costs	<u>2,295</u>
Cerro-Marmon's cost of 54.67% of Cerro	91,923
Proposed litigation settlement cost to be paid by GL (Note 16)	<u>2,336</u>
Cerro-Marmon's basis in net assets of Cerro at February 24, 1976	<u>\$ 174,287</u>

Summarized information follows as to Cerro's net assets at December 31, 1975 and February 24, 1976 (unaudited) and the amounts at which Cerro's net assets at February 24, 1976 were included in the Cerro-Marmon balance sheet at that date after making the purchase cost allocations discussed below.

	Cerro At December 31, 1975	Cerro At February 24, 1976	Cerro-Marmon At February 24, 1976
	(In millions of dollars)		
Current assets	\$ 301.9	\$ 308.3	\$ 308.3
Current liabilities	<u>141.3</u>	<u>142.4</u>	<u>142.4</u>
Working capital	160.6	165.9	165.9
Trucking subsidiary	28.1	28.9	14.4
Real estate subsidiaries	34.7	34.6	14.9
Notes due from Chile	13.2	12.0	15.1
Future income tax benefit	41.4	37.8	
Investments and other assets	16.7	16.1	2.8
Property, plant and equipment	136.3	135.4	59.4
Intangibles	<u>5.0</u>	<u>4.9</u>	<u>1.8</u>
	436.0	435.6	274.3
Less:			
Long-term obligations	89.3	86.3	84.1
Deferred credit from acquisition			4.1
Other non-current amounts	<u>5.5</u>	<u>7.5</u>	<u>11.8</u>
Net assets	<u>\$ 341.2</u>	<u>\$ 341.8</u>	<u>\$ 174.3</u>

The allocations of purchase cost to Cerro's net assets were made as of August 1, 1974 as to the 45.33% interest in Cerro acquired as of that date and as of February 24, 1976 as to the 54.67% interest in Cerro acquired as of that date. The initial tentative allocations of purchase cost, as reported in the Cerro-Marmon report to shareholders for the first quarter of 1976, have been revised to reflect additional information obtained subsequently, including the substantial resolution of various uncertainties relating to the real estate operations and the amount of proceeds received or to be received from the dispositions of certain assets and operations. The effect of the purchase cost allocations was to significantly reduce the amounts at which Cerro's net assets are included in the Cerro-Marmon consolidated balance sheet from amounts previously reflected in Cerro's historical consolidated balance sheet. Reductions were made principally to investments (including the investment in the real estate subsidiaries), property, plant and equipment, intangible assets and the asset included in the Cerro balance sheet for future income tax benefit. The purchase cost

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allocation shown above and the effects thereof on results of operations discussed below are subject to retroactive revision to reflect the resolution of certain specific matters as discussed in Note 3.

The purchase cost allocations had the effect of significantly increasing the amount reflected by Marmon as its equity in the net income of Cerro prior to February 25, 1976 and the net income of Cerro-Marmon subsequent thereto. This effect results principally from (1) reductions in depreciation, depletion and amortization of property, plant and equipment and intangible assets, (2) larger gains or lesser losses from dispositions of assets and (3) elimination of net losses from the real estate operations for periods through December 31, 1976, as discussed in the following paragraph.

For purposes of determining Marmon's equity in Cerro's net income prior to February 25, 1976 and Cerro-Marmon's results of operations from February 25 to December 31, 1976, the net losses of the nonconsolidated real estate subsidiaries were charged to a reserve established therefore in connection with the purchase cost allocations because significant uncertainties precluded an allocation of purchase cost to the net assets of these subsidiaries at the dates of purchase. As discussed more fully in Note 9, various of the uncertainties as to the real estate operations were substantially resolved as of December 31, 1976 and a purchase cost allocation was made; therefore, the results of operations of the real estate subsidiaries will be reflected in consolidated net income beginning January 1, 1977.

Had the merger of Cerro into Cerro-Marmon been consummated on January 1, 1975, the pro forma revenue and net income for 1976 and 1975 would have been as follows:

	<u>1976</u>	<u>1975</u>
	(Unaudited)	(Unaudited)
Revenues	<u>\$921,323</u>	<u>\$767,331</u>
Income from continuing operations	\$ 41,624	\$ 35,170
Income from discontinued business	<u>3,586</u>	<u>3,428</u>
Net income	<u>\$ 45,210</u>	<u>\$ 38,598</u>

The above pro forma amounts consist of the historical amounts applicable to Marmon and Cerro for the year 1975 and the period January 1, 1976 to February 24, 1976, all adjusted on a pro forma basis to give effect to the adjustments resulting from the merger of Cerro into Cerro-Marmon, and the reported amounts applicable to Cerro-Marmon for the period subsequent to the merger date, both adjusted to reflect the discontinuance of trucking operations. As noted above, no amounts are included for the real estate subsidiaries. See Note 19 for data as to the acquisition of Hammond Corporation in January 1977.

### 3. Uncertainties

Significant uncertainties relating to the former Cerro operations existed at December 31, 1975 and February 24, 1976. Such uncertainties related principally to the real estate operations (Leadership) and, as a result thereof, to the realizable value of Cerro's asset "Future income tax benefit". As discussed in Note 9, various of the uncertainties relating to the real estate operations have been substantially resolved, with the major remaining uncertainty relating to the ultimate liability that may result from a guarantee by Leadership of debt of a joint venture in which Leadership participates. Such resolution had no material effect on the consolidated financial statements of Cerro-Marmon and the resolution of the remaining uncertainties will have no material effect on such financial statements. Further, no purchase cost was allocated to Cerro's asset, "Future income tax benefit", which is being accounted for as realized as discussed in the following paragraph.

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Income tax matters, including matters relating to Cerro's prior year federal income tax position, are discussed in Note 15. On the basis of presently known information, management of Cerro-Marmon does not anticipate any significant change in the prior year federal income tax position of Cerro from that reflected on Cerro's income tax returns other than as provided for. Further, Cerro-Marmon's management anticipates that the amount of future income tax benefit available from Cerro's prior year losses will be ultimately realized. However, because of the complexities of the matters and because no member of Cerro-Marmon's management was a part of Cerro management prior to 1975, Cerro-Marmon will continue to include all income tax benefits realized from prior year losses of Cerro in the "Deferred credit from acquisition" in the Cerro-Marmon consolidated balance sheet (rather than being partially applied to reduce the purchase cost allocated to Cerro's former property, plant and equipment) and to reflect no amortization of the deferred credit in income until the matters referred to above, including the matter relating to Leadership, are resolved. The effect thereof on the 1976 consolidated financial statements was not material. Upon resolution, the purchase cost allocated to Cerro's net assets will be retroactively revised to reflect any adjustments resulting from (1) the realization of income tax benefits from prior year losses of Cerro and (2) the outcome of the matters discussed above relating to Leadership and the prior year federal income tax position of Cerro. Further, provisions for depreciation and depletion will be retroactively adjusted to reflect the effects of any revision of purchase cost allocated to property, plant and equipment and amortization of any deferred credit will be retroactively included in income. Any retroactive adjustments required will not have a material effect on the 1975 consolidated financial statements or consolidated working capital and shareholders' equity at December 31, 1976, nor will the effects of any such adjustments exceed 10% of reported consolidated net income for 1976.

#### 4. Summary of Accounting Policies

The significant accounting policies of Cerro-Marmon are as follows:

##### (A) Consolidation policy

The consolidated financial statements include the accounts of all significant subsidiaries except the real estate subsidiaries (Notes 2 and 9) and the trucking subsidiary to be sold (Note 8). See Note 1 for the basis of the consolidated financial statements. All significant intercompany balances and transactions have been eliminated.

##### (B) Inventories

Inventories, other than metal trading inventories, are valued at the lower of cost or market. The cost of inventories comprising 22% and 82% of consolidated inventories in 1976 and 1975, respectively, is determined under the last-in, first-out (LIFO) method. Cost of the remaining inventories, other than metal trading inventories, represents current cost (standard, average or first-in, first-out).

Metal trading inventories and open positions (outstanding futures contracts, unfulfilled physical purchase and sale commitments and related foreign currency commitments) are valued at market and the resultant gain or loss is reflected in results of operations.

##### (C) Investments

Investments in marketable securities are carried at the lower of cost or market.

The investment in the real estate subsidiaries is carried at cost to Cerro-Marmon, which will be adjusted beginning January 1, 1977 for Cerro-Marmon's equity in the subsidiaries' net income or loss (Notes 2 and 9).

The investment in the trucking subsidiary, which is to be sold, is carried at Cerro-Marmon's cost, adjusted for Cerro-Marmon's equity in the subsidiary's undistributed net income subsequent to dates of acquisition (Note 8).

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The investment in Cerro was accounted for by Marmon on the equity method through February 24, 1976. Marmon's equity in Cerro's reported net income was adjusted to reflect the effects of the differences between Marmon's cost and its equity in the net assets of Cerro at August 1, 1974, the date of acquisition by Marmon of its 45.33% interest in Cerro.

Other investments, including investments in affiliated companies, principally Southern Peru Copper Corporation (SPCC) (Note 10), a 21.02% owned affiliate, are carried at cost or less. Income is recognized only upon receipt of dividends. The cost method is used for the investment in SPCC because it is domiciled in a country with significant foreign exchange restrictions. The other affiliates are not significant.

(D) Property, Plant and Equipment

Property, plant and equipment are recorded at cost to Cerro-Marmon, less accumulated depreciation and depletion. Gain or loss on sales or retirements is included in earnings. Maintenance and repairs are expensed; renewals and betterments are capitalized. Depreciation is based on the estimated service lives of the assets using primarily accelerated methods. Depletion of mining properties is based on the units-of-production method.

(E) Income Taxes

Deferred taxes are provided to account for the differences for accounting and tax purposes in the timing of the recognition of certain income and expense items. These differences consist principally of allowances for losses and accrued expenses not yet deductible for income tax purposes, gains from certain metal trading activities not yet taxable and, in 1975, the equity in the undistributed net income of Cerro as to which deferred income taxes were provided on the basis that the undistributed earnings would be received as a dividend and subject to the statutory dividend exclusion.

Investment tax credits are accounted for as reductions of the current provision for U.S. income taxes as such credits are earned.

(F) Retirement Plans

Pension costs, actuarially determined and generally funded as accrued, consist of current service costs, interest on unfunded past service liabilities and amortization of prior service costs over periods not exceeding 40 years. Profit sharing plan costs are recorded in amounts approved by the Board of Directors as contributions to the profit sharing plan trusts.

5. Notes Due from Chile

In connection with the 1971 expropriation of a Chilean mining company, formerly 70% owned by Cerro, the Government of Chile issued 9.165% Series A and B Notes, payable \$2,700,000 semi-annually including interest, which are exempt from Chilean taxes and guaranteed by the Central Bank of Chile. An agency of the United States government has guaranteed the payment of a portion of the principal amount of the Series B Notes and the interest thereon (\$3,100,000 as of December 31, 1976).

The principal amount of notes outstanding at December 31, 1976 of \$10,400,000 exceeds Cerro-Marmon's carrying value by \$1,900,000. This amount is being reflected in earnings over the remaining scheduled collection period (to March 1, 1979).

## 6. Inventories

	December 31,	
	1976	1975
Metal trading inventories	\$ 63,326	
Coal inventories and supplies	9,424	
Manufacturing inventories and supplies	129,370	\$ 50,781
	<u>\$ 202,120</u>	<u>\$ 50,781</u>

Inventories valued under the LIFO method were approximately \$27,200,000 less than the current costs of such inventories at December 31, 1976 (\$25,300,000 at December 31, 1975). Reductions in the levels of certain inventories carried at LIFO costs, which were less than current costs, increased net income by approximately \$600,000 in 1976 (\$1,000,000 in 1975). The classification of manufacturing inventories by stage of production is not available from the accounting records.

Cerro-Marmon entered into certain arrangements for the future delivery of copper in December 1976 and approximately \$50,000,000 was received as advance payments on these sales. For financial statement purposes, these advanced copper sales are not reflected as sales until the copper is delivered and Cerro-Marmon's obligation is satisfied. The cash received as advance payments was temporarily invested and is included in "Time and certificates of deposit" in the consolidated balance sheet and the liability for the cost of the copper to be delivered is included in "Accounts payable". See Note 15 for the income tax treatment of these advance payments.

## 7. Investment in Cerro Corporation

Effective August 1, 1974, Marmon acquired 3,586,297 common shares of Cerro, representing 45.33% of the outstanding common shares of Cerro at that date, for a total cost of \$67,846,000. The Cerro stock held by Marmon was cancelled on February 24, 1976 in connection with the merger of Cerro into Cerro-Marmon (Note 1).

Summarized information as to Cerro's net assets at December 31, 1975 and February 24, 1976 is presented in Note 2. Marmon's equity in the net income of Cerro for the year ended December 31, 1975 and the period January 1 to February 24, 1976 was determined as follows:

	Period Jan. 1 to Feb. 24, 1976	Year ended Dec. 31, 1975
Marmon's equity (45.33%) in the reported net income (loss) of Cerro	\$ 921	\$ (1,092)
Adjustments to reflect the effects of the allocation of Marmon's purchase cost of the Cerro stock to Marmon's proportionate interest in Cerro's net assets at August 1, 1974 as discussed in Note 2:		
Reduction in depreciation and amortization of Cerro's property, plant and equipment and intangible assets	652	4,212
Elimination of the net loss from real estate operations	353	9,604
Other - net	(144)	310
Marmon's equity in Cerro's net income, as adjusted	<u>\$ 1,782</u>	<u>\$ 13,034</u>

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Marmon's equity in Cerro's net income is presented in the consolidated statement of income as follows:

Continuing operations	\$ 1,436	\$ 10,384
Discontinued business	<u>346</u>	<u>2,650</u>
	<u>\$ 1,782</u>	<u>\$ 13,034</u>
Dividends received from Cerro	<u>\$ 650</u>	<u>\$ 4,303</u>

As discussed in Note 2, the net losses from the real estate operations were eliminated from Marmon's equity in the net income of Cerro by charges to a reserve established therefore in connection with the purchase cost allocation. The method used to determine the amounts charged to such reserve by Marmon prior to February 25, 1976 differed from the method used by Cerro-Marmon subsequent thereto but the result determined by Marmon was substantially identical to the result obtained by use of the Cerro-Marmon method.

Revenues of Cerro, after restatement for the discontinued trucking business and the real estate subsidiaries, were \$489,772,000 in 1975 and \$82,151,000 in the period January 1 to February 24, 1976.

#### 8. Investment in Trucking Subsidiary

Cerro-Marmon intends to sell its majority-owned trucking subsidiary, ICX Industries, Inc., to ICX Corporation, a corporation formed by certain employees of the trucking subsidiary, for approximately \$22,600,000 in cash, a subordinated note of approximately \$5,500,000 (subject to changes in net asset value of the subsidiary to date of sale), which bears interest at prime plus 4½% per annum, and a 19.8% equity interest in ICX Corporation. Such sale is expected to be completed in June 1977. Accordingly, the trucking subsidiary is reflected in the financial statements as a discontinued business. The gain to be realized on the sale, before income taxes, is estimated at approximately \$5 million based on the cash proceeds to be received. The gain represented by the notes and stock will be reflected as amounts are realized in cash.

Net assets applicable to the discontinued trucking operations, after giving effect to Cerro-Marmon's purchase cost allocations, at December 31, 1976 follow:

Current assets	\$ 8,078
Current liabilities	<u>7,535</u>
Net current assets	543
Property and equipment - net	13,743
Operating rights and other assets	6,183
Non-current obligations	<u>(3,460)</u>
Net assets	<u>\$ 17,009</u>

The amounts shown in the consolidated statement of income as income of discontinued business for periods prior to February 25, 1976 consist of Marmon's 45.33% equity in the net income of Cerro's trucking subsidiary, less Marmon's income taxes relating thereto, and for the period February 25 to December 31, 1976 consists of the adjusted income of the trucking subsidiary, less related income taxes (Note 15).

For the period February 24, 1976 through December 31, 1976, ICX Industries, Inc. reported revenues of \$71,126,000.

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## 9. Investment in Real Estate Subsidiaries

The nonconsolidated real estate subsidiaries consist of Leadership Housing, Inc. (Leadership) and The Housing Group, Inc. (Housing Group) and their subsidiaries. Housing Group was formed during 1976 by the transfer of certain assets from Leadership. Amounts relating to the real estate subsidiaries at December 31, 1976 consist of the following:

Advances	\$ 19,493
Investment	<u>542</u>
Total	<u>\$ 20,035</u>

The above amounts represent the results of the allocation of the purchase cost of Cerro to the real estate subsidiaries. The amount shown as investment is equal to the stockholder's equity shown in the subsidiaries' balance sheets as of December 31, 1976, reduced to reflect the effects of the purchase cost allocation to the net assets of these subsidiaries.

No amounts have been included in the consolidated results of operations applicable to the real estate subsidiaries as the loss incurred by these subsidiaries was charged to a reserve established for such purpose by the initial purchase cost allocations. This reserve was established because various uncertainties relating to the real estate operations precluded an allocation of purchase cost to the real estate assets at the dates of acquisition of Cerro. Certain of these uncertainties were substantially resolved by the modification of certain agreements and restructuring of debt obligations concluded in February 1977, the reductions in inventories and the restructuring of the activities of the real estate subsidiaries, and the general improvement in the market in the various areas in which the real estate operations are conducted. Uncertainties remaining are discussed elsewhere in this note. The most significant remaining uncertainty relates to the guarantee of debt of a joint venture in which Leadership is a participant (See B in this Note). The above described events permitted a quasi-reorganization of Leadership as of December 31, 1976 at which date its assets were revalued to reflect their fair market values. These revised asset values were used as the basis for finalizing the purchase cost allocation to the real estate assets and to Cerro-Marmon's investment in the real estate subsidiaries. Commencing January 1, 1977, Cerro-Marmon will reflect its equity in the net income or loss of the real estate subsidiaries in the consolidated financial statements.

For the year ended December 31, 1976, the real estate subsidiaries reported a loss before income taxes of \$18,336,000 on sales of \$56,836,000. This loss, which is based on the historical financial statements of the real estate subsidiaries before giving any effect to purchase cost allocations, was charged to the reserve established therefore as discussed above.

A condensed pro forma combined balance sheet of the real estate subsidiaries at December 31, 1976, after giving effect to the above-mentioned quasi-reorganization of Leadership, modification of certain agreements and restructuring of debt obligations completed in 1977, and after reflecting the purchase cost adjustments to the real estate subsidiaries' net assets, follows:

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Real Estate Subsidiaries  
Condensed Pro Forma Combined Balance Sheet  
December 31, 1976

ASSETS:

Cash	\$ 4,413
Receivables	8,329
Inventories (A)	71,806
Investment in joint ventures (B)	1,530
Property and equipment - net	2,204
Other assets (C)	<u>4,249</u>
	92,531

LESS:

Notes payable (D)	\$ 54,250
Accounts payable and accrued liabilities	<u>18,246</u>

72,496

Cerro-Marmon's equity and advances \$ 20,035

(A) Inventories

Inventories are carried at the lower of cost or estimated net realizable value, which amount approximates fair market values at December 31, 1976. The estimated net realizable values have been determined based on dispositions in the normal course of business under existing and anticipated market conditions.

The inventories at December 31, 1976 consist of:

Land and land improvement costs	\$ 53,460
Developments completed or in progress	<u>18,346</u>
	<u>\$ 71,806</u>

(B) Investment in Joint Ventures

The investment at December 31, 1976 consists of:

Notes receivable	\$ 4,247
Notes payable	(2,722)
Equity	4,480
Reduction for effect of reduced income tax basis	<u>(4,475)</u>
	<u>\$ 1,530</u>

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The equity investment shown above represents the estimated fair value of Leadership's equity in the underlying net assets of the joint ventures. These net assets are summarized as follows:

Receivables	\$ 12,855
Inventories	84,761
Other assets	<u>3,905</u>
	101,521
Notes and mortgages payable	\$ 72,623
Other liabilities	<u>6,600</u>
	<u>79,223</u>
	<u>\$ 22,298</u>
Equity -	
Leadership	4,480
Venture partners	<u>17,818</u>
	<u>\$ 22,298</u>

Leadership participates in four joint ventures. Two of these joint ventures are with certain Pritzker Trusts (the Pritzker family, through trusts and other entities own all of the outstanding capital stock of GL Corporation, Cerro-Marmon's parent) each of which provides for Leadership's participation in 50% of the profits and losses. These two ventures hold unimproved property and have not made any sales. While Leadership has no investment in these particular ventures, it is contingently liable to lenders for approximately \$19,200,000 of notes payable by the joint ventures. Leadership, however, would have recourse to the joint ventures. At December 31, 1976, approximately \$18,200,000 of such debt of one of the joint ventures was in default and actions for foreclosures had been filed by certain noteholders. The ultimate exposure to Leadership of these contingencies cannot be determined and no provision has been included in the financial statements as of December 31, 1976.

(C) Other Assets

Other assets include \$2,255,000 due from The Communities Group, Inc. of Broward County (Communities), a subsidiary of GL. During 1976, Leadership sold to Communities approximately \$2,243,000 of land at book value subject to existing indebtedness of approximately \$333,000.

(D) Notes Payable

Notes payable at December 31, 1976, after giving effect to a February 22, 1977 exchange of assets by Leadership for the cancellation of a bank loan agreement, are as follows:

Financial institutions -	
Unsecured, non-interest bearing, due \$3,000,000 annually	\$ 9,510
Secured, interest from 8.75% to prime plus 4%, due in installments	7,690
Other, substantially all secured, discounted to provide effective interest rates of 8% to 10%, due in installments	<u>37,050</u>
	<u>\$ 54,250</u>

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The unsecured note, which has a face value of \$12,000,000 and has been discounted to reflect a 10% interest rate, is guaranteed by Cerro-Marmon.

A Master Loan Agreement with a bank imposes certain restrictions on Housing Group, including restrictions on the payment of dividends and redemption of stock.

(E) Other Matters

In connection with a 1972 sale of land to the Pritzker Trusts, Leadership was required to repurchase certain portions of such land and had an option to purchase another portion. The repurchase price was Leadership's sales price, the Trust's development and carrying costs and a specific premium. In February 1977, Leadership and the Trusts agreed to cancel each others' rights and obligations in connection with the repurchase and other related agreements. Under terms of the cancellation agreement, a purchase money second mortgage held by Leadership was modified with respect to payment terms, such that the ultimate collectibility cannot be determined and, therefore, the mortgage note receivable of \$2,980,000 has not been reflected in the balance sheet of Leadership.

As a result of the formation of Housing Group and Communities, Leadership is no longer involved in the construction and sale of single family houses, condominiums or multi-family projects. Leadership's future activities will be limited principally to the sale of land presently owned to Communities and other buyers.

The real estate subsidiaries are liable for obligations incurred in the normal course of business for rentals, the completion of contracts relating to the construction of houses, purchases of land, improvements of property sold and guarantees to purchasers of apartment projects. In addition, real estate development is contingent on obtaining required approvals and permits from various government agencies. Leadership is a defendant in lawsuits arising in the normal course of business and is obligated under long-term leases for which provision has been made for the possible loss from these and certain other claims and obligations.

10. Investments - Other

Other investments consist of:

	December 31,	
	1976	1975
Southern Peru Copper Corporation	\$ 5,450	
Miscellaneous (principally foreign)	<u>2,200</u>	<u>\$ 1,569</u>
	<u>\$ 7,650</u>	<u>\$ 1,569</u>

Southern Peru Copper Corporation (SPCC)

Although management believes the investment in SPCC has significant value, no portion of Cerro-Marmon's purchase cost of Cerro was assigned to the investment in SPCC as an appropriate basis for assigning such cost was not readily available. An allocation of a portion of the purchase cost to the investment in SPCC would not have materially affected the consolidated financial statements of Cerro-Marmon. The amount shown for the investment in SPCC represents amounts invested in SPCC after February 24, 1976.

In late February 1976, Cerro-Marmon contributed \$4,450,000 to the capital of SPCC, its then proportionate share (22.25%) of a capital subscription aggregating \$20,000,000. This capital subscription was required by SPCC's lenders, prior to the lenders granting waivers under their financing agreements with SPCC, so that SPCC could obtain additional credit to meet cost overruns incurred in the development of its Cuajone mine. Because the projected costs of Cuajone

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exceeded available funds, including the above \$20,000,000, SPCC's lenders required an additional equity offering of \$25,000,000. Cerro-Marmon contributed \$1,000,000 under such offering, which had the effect of reducing Cerro-Marmon's equity interest in SPCC to 21.02%.

SPCC has not paid dividends since 1972. SPCC's net income (loss) was \$8,354,000 and (\$9,597,000) for 1976 and 1975, respectively. Cerro-Marmon's equity in SPCC's net assets, as reported by SPCC, was \$62,478,000 at December 31, 1976.

Pursuant to Peruvian law, the mining community, made up of SPCC's employees, will acquire increasing participation in the profits and ownership (eventually to 50%) of the mining enterprises in which they are employed.

#### Investments Sold in 1976

During 1976, Cerro-Marmon sold (1) its investment in a 71.25% owned subsidiary in Greece (Zidani Asbestos Mine Project), (2) the assets of Cerro Spar Corporation, a wholly-owned domestic fluorspar mining company and (3) its 24% interest in Northwest Iron Co., Ltd. (Northwest). The gain from these sales, less operating losses in 1976 to dates of sale, of \$948,000 is included in "Revenues - miscellaneous" in the consolidated statement of income.

Cerro-Marmon is contingently liable, together with the major stockholder of Northwest, to advance sufficient funds to Northwest to maintain working capital, as defined, at \$500,000 until certain indebtedness (\$10,879,000 outstanding at December 31, 1976) is repaid. In connection with the sale by Cerro-Marmon of its interest in Northwest, the major stockholder of Northwest has agreed to hold Cerro-Marmon harmless with respect to this working capital maintenance obligation. Management does not expect Cerro-Marmon to be required to make any payments as a result of this contingent obligation.

#### 11. Property, Plant and Equipment

Property, plant and equipment are summarized below:

	December 31,	
	1976	1975
Land	\$ 3,779	\$ 2,064
Buildings and improvements	31,562	21,590
Machinery and equipment	64,158	34,027
Mining properties	20,264	
Utility plant	6,198	
Construction in progress	6,272	424
	<u>132,233</u>	<u>58,105</u>
Less accumulated depreciation and depletion	<u>32,141</u>	<u>21,884</u>
	<u>\$ 100,092</u>	<u>\$ 36,221</u>

#### 12. Financing Obligations

(A) The following table summarizes long-term debt and lease purchase obligations:

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	Interest Rate	Due	December 31,	
			1976	1975
Notes to banks (a)	Prime plus ½% and 1%	1977-1981		\$ 68,000
Notes to institutions (b)	6%-6-3/8%	1977-1987	\$ 27,636	
Notes to corporations (c)	9½%	1977-1987	35,000	
Notes to individuals (d)	5%	1977-1980	7,446	
Subordinated debentures (e)	7%	1977-1990	3,756	
Subordinated notes	12%	1977-1981	3,863	
Lease purchase obligations (f)	3½%-9½%	1977-1994	21,485	17,307
Other	5%-10%	1977-1990	10,053	979
			<u>109,239</u>	<u>86,286</u>
Less current portion			<u>11,800</u>	<u>4,886</u>
			<u>\$ 97,439</u>	<u>\$ 81,400</u>

- (a) This debt of Marmon was prepaid in 1976 with funds obtained from a \$25,000,000 cash contribution by Cerro-Marmon and a \$26,000,000 demand loan from Cerro-Marmon together with Marmon's internally generated funds.
- (b) Discounted to an effective interest rate of 9%.
- (c) Secured by certain coal mining properties.
- (d) To be paid as cash is generated by certain coal mining operations, with payments estimated to be made annually in approximately equal amounts. Discounted to an effective interest rate of 9½%.
- (e) Convertible into common stock of Cerro-Marmon's subsidiary (Golconda Corporation) at \$10.67 per share and redeemable at Golconda's option at prices slightly above par. The amount shown has been discounted to an effective interest rate of 10%.
- (f) Secured by certain property, plant and equipment.

Scheduled maturities of the long-term debt and lease-purchase obligations in the calendar years 1978-1981 are \$12,919,000 in 1978, \$12,270,000 in 1979, \$9,669,000 in 1980 and \$10,555,000 in 1981.

The various debt agreements impose certain restrictions on Cerro-Marmon and certain subsidiaries (including Marmon), including restrictions on the payment of cash dividends and the repurchase of capital stock. Pursuant to the most restrictive provisions of the agreements, Cerro-Marmon could not pay dividends on or repurchase common stock at December 31, 1976. However, under the agreements there was approximately \$60,000,000 available for the payment of dividends on, and redemptions of, preferred stock at that date.

(B) Certain subsidiaries have a formal domestic credit line, expiring April 30, 1977, in the amount of \$12,500,000 and informal domestic and foreign credit lines in the amount of \$61,000,000. All significant credit lines provide for informal compensating balance requirements, generally in an amount equal to 10% of the credit line or 10% of outstanding borrowings thereunder. In one instance a credit line restricts dividend payments and stock repurchases by a subsidiary. Compensating balance requirements are generally satisfied by the normal time lag in presentation of checks for payment.

The daily weighted average short-term bank borrowings and the maximum amount of aggregate short-term bank borrowings outstanding at any month end during 1976 were \$14,080,000 and \$39,480,000, respectively. The weighted average interest rates at December

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31, 1976 and for the year then ended were 8.26% and 7.39%, respectively. Unused credit lines at December 31, 1976 aggregated \$34,020,000.

Notes payable to banks at December 31, 1976 were collateralized by a substantial portion of metal trading inventories (Note 6).

### 13. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31,	
	1976	1975
Compensation	\$ 8,132	\$ 3,256
Pension and profit sharing	5,337	2,252
Insurance	5,310	1,633
Taxes, other than income taxes	3,996	674
Interest	1,571	963
Other	9,185	1,833
	<u>\$ 33,531</u>	<u>\$ 10,611</u>

### 14. Retirement Plans

Cerro-Marmon has several pension and profit sharing plans covering substantially all of its employees.

The actuarially computed value of vested benefits under the pension plans exceeded, as of December 31, 1976, the respective pension fund assets and related balance sheet accruals by approximately \$9,400,000. At that date unfunded past service costs totalled approximately \$18,500,000.

Retirement plan expense included in the consolidated statement of income is as follows:

	1976	1975
Pension plans	\$ 4,782	\$ 1,221
Profit sharing plans	1,349	1,081
	<u>\$ 6,131</u>	<u>\$ 2,302</u>

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## 15. Income Taxes

Cerro-Marmon will be included in the consolidated federal income tax return of GL. Prior to February 25, 1976, Marmon was included in GL's consolidated federal income tax return. Pursuant to a formal tax sharing agreement with GL, federal income taxes of Cerro-Marmon will be determined, in general, as if the former Cerro affiliated tax group and the former Marmon affiliated tax group each filed separate consolidated tax returns. Prior to February 25, 1976, federal income taxes of Marmon were determined, in general, as if Marmon and its domestic subsidiaries filed a separate consolidated federal income tax return. Federal income taxes so determined are to be paid periodically to GL except that (1) the former Cerro affiliated tax group shall not be required to make any tax sharing payments during any taxable period in which Cerro-Marmon has not currently paid all prescribed dividends or made sinking fund payments on its Series A preferred stock and (2) during all other taxable periods the former Cerro affiliated group shall retain, without restriction, 50% of any tax sharing payments that would be due to any member of the GL affiliated group. No income taxes are payable to GL by the former Cerro affiliated group for 1976. As a member of the GL consolidated federal income tax group, Cerro-Marmon (and Marmon prior to February 25, 1976) is contingently liable for the federal income taxes of the other members of the group. GL has indemnified Cerro-Marmon (and Marmon) for any federal income taxes attributable to other members of the group.

Federal income taxes accrued but not yet paid to GL and payments to GL in excess of amounts accrued are included in "Income taxes" and as "Refundable income taxes", respectively, in the consolidated balance sheet. Interest at 115% of the prime rate of a specified bank is paid or received on differences between payments made and payments due. The amount shown as "Income taxes" in the December 31, 1976 consolidated balance sheet includes \$1,108,000 of deferred income taxes.

Examinations by the Internal Revenue Service (Service) of Cerro's federal income tax returns for the years 1965 through 1971 have been substantially completed and additional liabilities have been proposed by the Service. The Service is in the initial stages of an examination of Cerro's federal income tax returns for the years 1972 through 1974 and has not progressed sufficiently to form any conclusions relating to matters reflected in such returns. Cerro's returns include the effects of complex transactions among which is the 1974 expropriation of Cerro's subsidiary, Cerro de Pasco (C de P), discussed below.

On January 1, 1974, C de P was expropriated by the Peruvian government resulting in a loss of \$135,000,000 which was reflected in Cerro's federal income tax return for 1974. On January 22, 1974, the Service advised Cerro by a private ruling letter that it considered the 1974 C de P expropriation loss to have resulted from a compulsory or involuntary conversion of the stock of C de P and that the loss qualified as an ordinary loss which could be carried over and applied against the Cerro affiliated group income for as long as ten years to the extent not utilized during the taxable year in which it arose. By letter dated May 12, 1976, the Service advised Cerro-Marmon that the January 22, 1974 ruling letter was being retroactively revoked with respect to the conclusion that the loss was an involuntary conversion of the stock of C de P and held that the transaction will be treated as an expropriation of assets. During the course of the current examination of Cerro's federal income tax returns, the Service has insisted upon physically examining the books and records of C de P in Peru in order to verify the basis of C de P's assets. To date the Service has not received permission from the Government of Peru to conduct the examination in Peru. Nevertheless, present management believes that the adjusted basis of C de P's assets ultimately can be established.

Income to be reported for income tax purposes for 1976 includes approximately \$50,000,000 from advanced payments received on copper sales. Certain prior returns of Cerro included amounts from similar sales. For income tax purposes, but not for financial reporting purposes, such payments are reported as sales in the year of receipt while the related cost of sales is reported at the time of delivery, which as to the 1976 sale occurred in January 1977. Generally, to the extent that the cost of copper sales reported at time of delivery is not offset by taxable income in the

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same year, a net operating loss will result which may (within certain limitations) be carried back and then, to the extent unused by carryback, carried forward against income of future years. Advance payment transactions, like other business transactions, are subject to examination by the Service. These transactions and any future advance payment transactions could influence the possibilities of ultimate realization of the future tax benefits available as well as the timing of such realization.

On the basis of presently known information, Cerro-Marmon management, who were not part of Cerro management in 1974 or prior years, believe (1) that adequate provision has been made for additional liabilities that may be assessed for the years 1965 through 1971, (2) that no significant change will be made in Cerro's federal income tax position for the periods subsequent to 1971 from that reflected on Cerro's income tax returns for such periods, and (3) that the federal income tax benefits available to Cerro-Marmon from prior losses of Cerro, which are in excess of \$25,000,000 at December 31, 1976, will be realized. However, as a result of the uncertainties raised by the retroactive revocation of the January 22, 1974 ruling letter, the present inability to obtain permission from the Government of Peru for the Service to travel to Peru and the matters discussed in Note 3, conservative accounting practice dictates that recognition of the income tax benefits of the prior Cerro losses be deferred until all significant matters relating to Cerro's prior year income tax position are resolved. See Note 3 as to Cerro-Marmon's accounting for the income tax benefits of Cerro's prior losses when such benefits are realized.

Income tax provisions consist of the following:

	<u>1976</u>	<u>1975</u>
United States:		
Current	\$ 13,096	\$ 10,331
Deferred	3,089	805
Provision in lieu of income taxes	7,397	65
Foreign:		
Current	162	
Deferred	720	355
State and other:		
Current	3,424	1,489
Deferred	<u>1,663</u>	
	<u>\$ 29,551</u>	<u>\$ 13,045</u>

The provisions shown above include the following amounts allocated to the discontinued trucking business.

	<u>1976</u>	<u>1975</u>
Relating to Marmon's equity in the net income of Cerro's trucking subsidiary prior to February 25, 1976	\$ 25	\$ 190
Relating to the trucking subsidiary subsequent to February 24, 1976	<u>1,476</u>	
	<u>\$ 1,501</u>	<u>\$ 190</u>

The income tax effects of significant items which resulted in effective tax rates of 42.6% in 1976 and 52% in 1975 on reported income before income taxes, equity in net income of Cerro and income of discontinued business are detailed below:

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	<u>1976</u>	<u>1975</u>
Theoretical federal income taxes (at 48%) on reported income	\$ 31,600	\$ 11,863
Increase (reduction) resulting from:		
Excess of tax depreciation over financial statement depreciation*	(1,747)	
Excess of tax depletion (percentage depletion basis) over financial statement depletion*	(964)	
Excess of financial statement gains on asset dispositions over tax basis amounts*	(2,417)	
State and other income taxes less federal income tax benefits	2,645	774
Investment tax credits	(902)	(526)
Taxes on Marmon's equity in net income prior to February 25, 1976 from continuing operations of Cerro	103	748
Other - net	(268)	(4)
Income taxes reported	<u>\$ 28,050</u>	<u>\$ 12,855</u>

\* The acquisition of Cerro was a non-taxable transaction and the income tax basis of Cerro's assets became Cerro-Marmon's income tax basis. Such tax basis exceeds the financial statement basis of certain property, plant and equipment and investments after the allocation of the purchase cost of Cerro (Note 2). This results in an excess of tax basis depreciation and depletion over the financial statement amounts and greater gains or lesser losses on disposition of these assets for financial statement purposes than for income tax purposes.

The effective income tax rate of 31.4% on income of the discontinued business subsequent to February 24, 1976 is less than 48% due principally to investment tax credits (\$190,000), the excess of tax over financial statement depreciation (\$582,000) and the excess of financial statement gains on property dispositions over the tax amount (\$211,000). Federal income taxes were provided at an effective rate of 7.2% on Marmon's equity in the net earnings of Cerro's trucking subsidiary prior to February 25, 1976 (Note 4E).

With the exception of \$3,015,000 of deferred federal income taxes provided in 1976 on certain metal trading gains and \$628,000 of deferred federal income taxes provided in 1975 applicable to the equity in the undistributed net income of Cerro, deferred federal income taxes applicable to each other type of difference are less than 5% of theoretical federal income taxes in each year. Provisions for federal income taxes are expected to exceed income taxes payable in the three years subsequent to 1976 due to the availability of prior Cerro losses.

#### 16. Litigation

(A) Cerro-Marmon is subject to the possible effects of various class action and derivative litigation commenced against several defendants, including GL, Cerro and Marmon in 1975 and 1976 relating principally to the termination agreement made with a former chairman of the board of directors of Cerro and the purchase of Cerro stock by Marmon and GL in 1974 and the subsequent merger of Cerro into Cerro-Marmon. These actions allege violations of the anti-fraud provisions of the federal securities laws and common law and derivative claims and various wrongdoings on the part of the various defendants and request various reliefs.

In April 1976, the parties involved in the actions agreed to two stipulations of settlement whereby (1) with respect to the class actions, GL is to pay for the benefit of the defined plaintiff classes (former Cerro common shareholders) up to \$2,336,000 for settlement of the actions, plaintiffs' counsels' fees and expenses and other costs and (2) with respect to the

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derivative actions, certain of the defendants, other than Cerro-Marmon, are to pay to Cerro-Marmon \$750,000 (including amounts to be paid for plaintiffs' counsels' fees and expenses) for settlement of the derivative claims. Further, Cerro-Marmon has agreed that any recovery from the above described derivative actions will be applied to the regular dividends on the \$2.25 Cumulative Series A Preferred Stock. The trial court approved the settlement terms of both the class actions and the derivative actions on January 10, 1977 and the derivative and class actions were dismissed. On February 7, 1977, a notice of appeal was filed with respect to the dismissal of the class action only. No appeal was taken with respect to the derivative actions and these actions have been disposed of; payment of the monies involved is expected to occur in the second quarter of 1977. The amount to be paid by GL pursuant to the class actions has been reflected in the 1976 Cerro-Marmon consolidated financial statements as a contribution to capital and as additional cost of Cerro stock acquired.

(B) In February 1976 another class action relating to the merger of Cerro into Cerro-Marmon was filed in New York State Court against several defendants including Marmon, Cerro and Cerro-Marmon. This action is based on several alleged causes of action, and asks that there be an injunction against a merger between Cerro and Cerro-Marmon that will divest the public shareholders from a residual equity position, or on terms other than as are presented to the court and determined by it to be fair, and for costs including attorneys' fees to the plaintiffs. In February 1976 the injunction to stay the merger was denied; this denial has been appealed. An action, substantially similar in all respects to the February 1976 action discussed above, except that it also alleges violation of the anti-fraud provision of federal securities law, was subsequently filed in Federal Court in New York. When the aforementioned appeal of the approval of the settlement and the class action dismissal is resolved, these cases will be disposed of in accordance with the resolution of the appeal.

In the opinion of counsel, the appeal of the dismissal of the class actions referred to in (A) above will not be sustained and the litigation referred to in (A) and (B) above will be settled on the basis described.

(C) As part of the business combination between GL, Marmon, Cerro and Cerro-Marmon, and specifically the merger of Cerro into Cerro-Marmon, 64,245 shares dissented as to said merger and are involved in a dissenting shareholders' appraisal proceeding which is currently pending in a New York State court. The sole issue to be determined in this proceeding is the price per share to be paid to the dissenting shareholders, and it is not expected that the decision rendered in this proceeding will have a materially adverse affect upon Cerro-Marmon.

(D) In September 1975 an action was commenced in the Supreme Court of the State of New York which alleges that certain defendants including GL, Marmon and Cerro owe the plaintiff a finder's fee of \$750,000 by reason of an alleged agreement to pay a finder's fee equal to the reasonable value of the plaintiff's services upon the acquisition of control of any business entity. The complaint also alleges that Cerro impliedly agreed to pay the plaintiff such a finder's fee and seeks damages against Cerro in the amount of \$750,000. This case has been dismissed in New York and refiled in the Federal Court in Illinois. The matter is currently pending. The outcome will not have a material effect on the consolidated financial statements of Cerro-Marmon.

#### 17. Capital Stock

The authorized capital stock of Cerro-Marmon consists of 10,000,000 shares of \$1 par value preferred stock and 10,000,000 shares of \$1 par value common stock.

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Preferred -

Shares issuable, February 24, 1976	4,324,970
Less - Shares surrendered for cash at \$19 per share	1,668
Shares in dissent seeking appraisal rights	<u>64,245</u>
Shares issued and outstanding at December 31, 1976 (including 141,769 shares held in trust for unlocated shareholders)	<u>4,259,057</u>

These shares, designated "\$2.25 Cumulative Series A Preferred Stock", became issuable under the terms of the merger agreement dated January 15, 1976. The preferred shares are entitled to dividends at the annual rate of \$2.25 per share on a cumulative basis, a liquidation preference of \$22 per share plus accrued dividends, and one vote per share. All or part of the Series A stock may be redeemed by Cerro-Marmon on or after April 1, 1981 at \$22 per share plus accrued dividends. Commencing in 1982, 6-2/3% of the Series A shares issued are to be redeemed annually until all such shares are redeemed or acquired by Cerro-Marmon. Pursuant to the terms of the settlement of certain litigation (Note 16), the annual dividend rate on the Series A stock will be increased to \$2.35 per share beginning in 1981.

The amount shown in the consolidated statement of income for the year ended December 31, 1976 as income applicable to preferred stock consists of \$8,136,000 of dividends and \$873,000 for the accrual of the excess of the redemption value over the value assigned to the Series A Preferred Stock, both for the period February 25, 1976 through December 31, 1976.

Common -

At December 31, 1976, 5,000,000 shares of common stock were issued and outstanding (entitled to four votes per share). Pursuant to the terms of the proposed settlement of certain litigation (Note 16), no payments can be made with respect to the common stock until consolidated shareholders' equity is \$10,000,000 greater than such equity on February 24, 1976. See Note 12 for restrictions on dividends under terms of the debt agreements.

18. Material Transactions with Affiliates

Significant amounts relating to transactions with affiliates during 1976 are as follows:

Management fee income	\$ 394
Interest income	292
Brokerage expense (coal sales)	819
Rental expense	443
Insurance premium expense	389

Amounts of sales to or purchases from affiliates and amounts of receivables from or payables to affiliates, other than amounts shown separately in the consolidated financial statements and income tax amounts (Note 15), are not material. See Note 9 with respect to related party transactions of the real estate subsidiaries.

19. Events Subsequent to December 31, 1976

On January 26, 1977 Hammond Corporation (Hammond) merged into Newham, Inc. (Newham), a newly created wholly-owned subsidiary of Cerro-Marmon, pursuant to a vote of shareholders on such date, approving an Agreement of Merger dated December 20, 1976. Prior to January 26, 1977 GL owned approximately 48% of Hammond's outstanding common stock. Such stock was acquired principally in 1973 and 1974.

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On January 26, 1977 GL contributed its shares of Hammond to the capital of Cerro-Marmon who contributed these shares to Newham. Cerro-Marmon paid \$200,000 to Newham for all of Newham's issued and outstanding common shares. Cerro-Marmon also contributed \$17,611,000 cash to the capital of Newham, which acquired, through a cash merger, all of the outstanding common stock of Hammond (held by persons other than Newham) for \$7.75 per share and all of the outstanding preferred stock of Hammond for \$75 per share. The shares of common stock of Hammond held by Newham and shares held in Hammond's treasury were cancelled. Newham, the surviving corporation, then changed its name to Hammond Corporation.

This transaction will be accounted for by Cerro-Marmon as a purchase. Accordingly, the net assets of the businesses formerly conducted by Hammond that are to be included in the consolidated balance sheet of Cerro-Marmon will be adjusted to reflect the allocations of purchase cost to Hammond's net assets. The carrying value of such net assets in Hammond's balance sheet exceeded Cerro-Marmon's cost of Hammond's net assets at January 31, 1977 (unaudited) by approximately \$3,500,000.

Had the acquisition of Hammond taken place on January 1, 1976, the consolidated net sales and net income of Cerro-Marmon for the year ended December 31, 1976, on an unaudited pro forma basis, would have been increased by approximately \$127,000,000 and \$4,000,000, respectively, after giving effect to a preliminary allocation of Cerro-Marmon's purchase cost of Hammond and to interest on the funds used in the purchase.

On March 31, 1977 a party claiming to be a former common shareholder of Hammond filed what is purported to be a class action against Hammond, Newham, GL and certain of the Cerro-Marmon directors, as well as Cerro-Marmon, alleging certain federal securities law violations, common law fraud and violation of fiduciary duties. The complaint and the allegations contained therein are currently being reviewed, but in the opinion of counsel the complaint is without merit and any decision rendered with respect to this proceeding will not have a materially adverse affect upon Cerro-Marmon.

Subsequent to December 31, 1976, Cerro-Marmon negotiated the termination of long-term employment and other related contracts with certain officers of a subsidiary at an estimated cost, before related income taxes, of approximately \$4,000,000.

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20. Quarterly Data (unaudited)

	1976 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
Sales:				
As previously reported	\$ 203,496	\$ 250,067	\$ 249,309	
As restated	194,662	221,188	214,103	\$ 209,192
Cost of sales:				
As previously reported	178,562	207,703	204,912	
As restated	170,914	183,973	172,181	176,447
Income before income taxes, equity in net income of Cerro and discontinued business:				
As previously reported	12,394	22,630	23,771	
As restated	11,715	19,190	23,163	11,765
Income from continuing operations:				
As previously reported	7,906	11,621	12,666	
As restated	8,159	11,014	13,294	6,752
Net income:				
As previously reported	7,906	11,621	12,666	
As restated	8,878	12,193	14,479	7,209

The restated amounts shown above reflect restatements for (1) amounts applicable to the trucking subsidiary classified as a discontinued operation in the fourth quarter, (2) reclassifications to cost of sales of certain amounts improperly included in revenues in the first three quarters, (3) adjustments to reflect the effects of changes in purchase cost allocations from the initial tentative allocations made in the first quarter and (4) retroactive reflection of certain inventory adjustments determined in the fourth quarter that were applicable to prior quarters.

21. Replacement Cost Data (unaudited)

Pursuant to a rule of the Securities and Exchange Commission, Cerro-Marmon's annual report on Form 10-K discloses quantitative information with respect to the estimated replacement cost of inventories and productive capacity at December 31, 1976 and the related estimated amounts of cost of sales and depreciation expense on a replacement cost basis for the year then ended. A copy of Cerro-Marmon's annual report on Form 10-K is available upon request.

Cerro-Marmon's reported operating results are significantly affected by the lower depreciation expense which results, in part, from the allocation of Cerro-Marmon's purchase cost to Cerro's net assets. The replacement of Cerro-Marmon's productive capacity would require a substantially greater capital investment than was required to acquire the existing productive capacity and, consequently, a substantially greater depreciation expense.

In the opinion of management, the replacement cost data contained in its 1976 Form 10-K is of little analytic value since the data does not necessarily reflect management's intentions as to replacement; additionally, the data necessarily involves highly subjective assumptions and judgments and does not address financing and operating cost considerations which would influence ultimate replacement decisions.

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CERRO-MARMON CORPORATION  
FIVE YEAR SUMMARY OF OPERATIONS (Note 2)  
(In thousands of dollars)

The following summary of operations consists of (1) the consolidated statement of income of Marmon (Cerro-Marmon's accounting predecessor company) and all subsidiaries, including Marmon's 45.33% interest in Cerro accounted for on an equity basis for periods prior to February 25, 1976, and (2) the consolidated statement of Cerro-Marmon and all significant subsidiaries, except the real estate subsidiaries and the trucking subsidiary which is to be sold, for the period commencing February 25, 1976. This statement should be read in conjunction with the consolidated statements of Cerro-Marmon and the Certified Public Accountants' report with respect thereto, which is qualified as set forth therein, and the pro forma summary of income contained elsewhere in this annual report to shareholders.

	<u>1976</u>	<u>1975</u>	<u>1974</u>	<u>1973</u>	<u>1972</u>
Revenues	<u>\$839,145</u>	<u>\$277,108</u>	<u>\$269,135</u>	<u>\$189,223</u>	<u>\$152,554</u>
Costs and expenses:					
Cost of sales	703,515	217,790	212,627	150,108	122,397
Selling and administrative	58,455	26,580	23,421	19,037	16,668
Interest	<u>11,342</u>	<u>8,024</u>	<u>5,314</u>	<u>723</u>	<u>850</u>
	<u>773,312</u>	<u>252,394</u>	<u>241,362</u>	<u>169,868</u>	<u>139,915</u>
Income before amounts shown below	65,833	24,714	27,773	19,355	12,639
Income taxes (Note 15)	<u>28,050</u>	<u>12,855</u>	<u>14,227</u>	<u>9,879</u>	<u>6,200</u>
Income before equity in net income of Cerro Corporation and discontinued business	37,783	11,859	13,546	9,476	6,439
Equity in net income of Cerro Corporation (Note 7)	<u>1,436</u>	<u>10,384</u>	<u>3,180</u>		
Income from continuing operations	39,219	22,243	16,726	9,476	6,439
Income of discontinued business less income taxes (Note 8)	<u>3,540</u>	<u>2,460</u>	<u>1,032</u>		
Net income	42,759	24,703	17,758	9,476	6,439
Net income applicable to preferred stock (Note 17)	<u>(9,009)</u>				
Net income applicable to common stock	<u>\$ 33,750</u>	<u>\$ 24,703</u>	<u>\$ 17,758</u>	<u>\$ 9,476</u>	<u>\$ 6,439</u>

Note references are to Notes to Consolidated Financial Statements.

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Lines of business information - historical (unaudited)

The following table sets forth the historical amounts of sales and income before income taxes from the continuing operations of Marmon for all periods prior to February 25, 1976 and Cerro-Marmon's amounts for the period from February 25, 1976 to December 31, 1976, adjusted to give effect to the merger of Cerro into Cerro-Marmon on February 24, 1976. This table should be read in conjunction with the pro forma statements and Managements' Discussion and Analysis of Results of Operations contained in this annual report to shareholders:

	<u>1976</u>	<u>1975</u>	<u>1974</u>	<u>1973</u>	<u>1972</u>
	(In millions of dollars)				
Sales:					
Manufacturing -					
Pipe and tubing (1)	\$180.0	\$ 88.9	\$105.9	\$ 69.5	\$ 46.1
Wire and cable (1)	102.0				
Metal products (1)	95.0				
Automotive products	92.3	76.2	75.0	52.1	43.2
Mining equipment	69.0	77.2	46.6	27.6	24.8
Building products	28.3	20.8	32.1	31.0	31.3
Total Manufacturing	566.6	263.1	259.6	180.2	145.4
Metal trading (1)	176.6				
Coal mining (1)	75.2				
All other	9.8	12.4	8.0	8.1	6.2
	<u>\$828.2</u>	<u>\$275.5</u>	<u>\$267.6</u>	<u>\$188.3</u>	<u>\$151.6</u>
Income from Continuing Operations:					
Manufacturing -					
Pipe and tubing (1)	\$ 14.3	\$ 5.9	\$ 15.2	\$ 7.3	\$ 3.0
Wire and cable (1)	8.7				
Metal products (1)	7.3				
Automotive products	9.2	7.8	6.3	6.4	4.3
Mining equipment	11.9	15.8	7.4	2.8	2.8
Building products	5.9	2.2	2.7	3.4	2.8
	57.3	31.7	31.6	19.9	12.9
Metal trading (1)	6.0				
Coal mining (1)	11.7				
All other (2)	(9.2)	(7.0)	(3.8)	(.5)	(.3)
	<u>\$ 65.8</u>	<u>\$ 24.7</u>	<u>\$ 27.8</u>	<u>\$ 19.4</u>	<u>\$ 12.6</u>

1. On February 24, 1976 Cerro-Marmon acquired Cerro, which businesses comprise all, or a major portion, of these lines of business. For information with respect to the discontinued trucking operations and real estate operations, see Notes 8 and 9 to Notes to Consolidated Financial Statements.

2. Includes interest and dividend income, gains or losses on temporary investments, residual amounts of unallocated or over-allocated corporate administrative expenses, interest expense, other than interest expense directly attributable to metal trading, and miscellaneous other amounts not attributable to a specific line of business.

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CERRO-MARMON CORPORATION  
PRO FORMA STATEMENT OF INCOME  
(In thousands of dollars)

(UNAUDITED)

	<u>Years Ended December 31,</u> <u>(Notes A and B)</u>	
	<u>1976</u>	<u>1975</u>
Revenues:		
Sales	\$908,390	\$753,837
Miscellaneous - net	<u>12,933</u>	<u>13,494</u>
	<u>921,323</u>	<u>767,331</u>
Costs and expenses:		
Cost of sales	772,311	622,657
Selling and administrative	63,412	62,685
Interest	<u>12,738</u>	<u>16,522</u>
	<u>848,461</u>	<u>701,864</u>
Income of continuing operations before income taxes	72,862	65,467
Income taxes	<u>31,238</u>	<u>30,297</u>
Income of continuing operations	41,624	35,170
Income of discontinued trucking business, less income taxes	<u>3,586</u>	<u>3,428</u>
Net income	<u>\$ 45,210</u>	<u>\$ 38,598</u>

See accompanying notes.

Lines of business information - pro forma (unaudited)

Years ended December 31,  
1976      1975  
(In millions of dollars)

Sales:

Manufacturing -		
Pipe and tubing (1)	\$ 194.8	\$ 147.0
Wire and cable (1)	118.0	115.8
Metal products (1)	113.1	76.7
Automotive products	92.3	76.2
Mining equipment	69.0	77.2
Building products	<u>28.3</u>	<u>20.8</u>
Total Manufacturing	615.5	513.7
Metal trading (1)	198.0	148.5
Coal mining (1)	85.2	80.0
All other	<u>9.7</u>	<u>11.6</u>
	<u>\$ 908.4</u>	<u>\$ 753.8</u>

Income from Continuing Operations:

Manufacturing -		
Pipe and tubing (1)	\$ 15.2	\$ 9.7
Wire and cable (1)	8.5	19.7
Metal products (1)	10.1	2.8
Automotive products	9.2	7.8
Mining equipment	11.9	15.8
Building products	<u>5.9</u>	<u>2.2</u>
	60.8	58.0
Metal trading (1)	6.1	3.6
Coal mining (1)	13.5	20.8
All other (2)	<u>(7.5)</u>	<u>(16.9)</u>
	<u>\$ 72.9</u>	<u>\$ 65.5</u>

- (1) On February 24, 1976 Cerro-Marmon acquired Cerro, which businesses comprise all, or a major portion, of these lines of business. For information with respect to the discontinued trucking operations and real estate operations, see Notes 8 and 9 of Notes to Consolidated Financial Statements.
- (2) Includes interest and dividend income, gains or losses on temporary investments, residual amounts of unallocated or over-allocated corporate administrative expenses, interest expense, other than interest expense directly attributable to metal trading, and miscellaneous other amounts not attributable to a specific line of business.

See accompanying notes.

LS 000821

NOTES TO UNAUDITED PRO FORMA STATEMENT OF INCOME  
AND LINES OF BUSINESS DATA

- A. The combination of Cerro and Marmon, as discussed in Note 1 of Notes to Consolidated Financial Statements, significantly affects the comparability of the 1976 results of operations of Cerro-Marmon with the 1975 historical results of operations of Cerro-Marmon's accounting predecessor company (Marmon). The accompanying pro forma information has been provided to facilitate a meaningful comparison of the results of operations for the two years. This pro forma information consists of (1) the combined historical results of Marmon and Cerro for the year ended December 31, 1975 and the period January 1 to February 24, 1976, adjusted to give effect to the allocation of Cerro-Marmon's purchase cost of Cerro to Cerro's net assets as if the merger and acquisition of Cerro had been completed on January 1, 1975, and (2) the historical results of Cerro-Marmon for the period February 25 to December 31, 1976. This information should be read in conjunction with the consolidated financial statements of Cerro-Marmon and related notes.
- B. The reconciliation of historical revenues and net income to pro forma amounts follows. The amounts shown for Cerro-Marmon consist of amounts applicable to Marmon prior to February 25, 1976 and to Cerro-Marmon subsequent thereto. The amounts shown for Cerro and the related pro forma adjustments apply only to periods prior to February 25, 1976.

	Years ended December 31,	
	1976	1975
Revenue:		
Cerro-Marmon	\$ 839,145	\$ 277,108
Cerro	<u>101,971</u>	<u>614,107</u>
Combined	941,116	891,215
Add (deduct) pro forma adjustments:		
Real estate subsidiaries	(6,816)	(49,077)
Discontinued trucking subsidiary	(13,004)	(75,258)
Other - net	<u>27</u>	<u>451</u>
Cerro-Marmon pro forma revenues	<u>\$ 921,323</u>	<u>\$ 767,331</u>
Net income:		
Cerro-Marmon	\$ 42,759	\$ 24,703
Cerro	<u>2,033</u>	<u>(2,410)</u>
Combined	44,792	22,293
Add (deduct) pro forma adjustments:		
Marmon's equity in Cerro net income less income taxes thereon	(1,655)	(12,096)
Net loss of Cerro's real estate subsidiaries	779	21,187
Reduction in Cerro's depreciation and depletion	1,304	6,517
Other - net	<u>(10)</u>	<u>697</u>
Cerro-Marmon pro forma net income	<u>\$ 45,210</u>	<u>\$ 38,598</u>

LS 000822

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS

The following comments relate to the preceding pro forma statement of income and lines of business data. For 1976, Cerro-Marmon had pro forma income from continuing operations before income taxes of \$72.9 million, an increase of 11% from the \$65.5 million in 1975. Pro forma sales for 1976 were \$908.4 million compared to \$753.8 million in 1975, an increase of 21%. Changes between 1975 and 1976 in pro forma sales and income from continuing operations before income taxes for each product line are discussed below.

### Pipe and Tubing

The year 1976 compared to 1975 shows significant improvements with an increase of 33% in sales and 57% in income. These improvements reflect the effect of a strike at a major plant in 1975 and, as to income only, the results of a cost reduction program initiated during the later part of 1975. General economic conditions effecting pipe and tubing customers also began to improve in the latter half of 1975 resulting in higher sales and income. Reductions in metal prices in the fourth quarter of 1976, while causing reduced dollar sales, had no significant effect on income.

### Wire and Cable

While sales increased 2% over 1975, income declined to less than half of the 1975 level. These results reflect severe price competition in 1976, due to reduced product demand in the construction and capital goods markets and the upward trend in the prices of copper and other related product costs during most of 1976. Declines in copper prices in the fourth quarter of 1976, requiring significant write-downs of inventory to market values, resulted in a loss in that quarter.

### Metal products

Substantial improvements in sales and income over the prior year reflect the effect of a strike at a major plant in 1975. Sales increased from \$76.7 million in 1975 to \$113.1 million in 1976 while income increased from \$2.8 million to \$10.1 million. Basic metal and product pricing improved throughout most of 1976 compared to the depressed levels of 1975 although a decline in copper prices in the fourth quarter resulted in significantly reduced income for the quarter due to inventory write-downs to market values.

### Automotive products

Due to direct association with the automotive industry, which had higher activity in 1976, sales and income of this line increased approximately 20%.

### Mining equipment

This operation experienced declines in both sales and income in 1976 resulting from a slowdown in demand for coal mining equipment from the abnormally high 1975 level. Sales of \$69 million decreased 11% from 1975's \$77.2 million and income declined 25% to \$11.9 million from 1975's \$15.8 million reflecting the effect of reduced demand on selling prices and margins. New orders for mining equipment started to decline in late 1975 and continued to decline through 1976.

### Building products

Sales and income for this line set an all-time record. Sales increased 36% over 1975 and income more than doubled. These results reflect the demand created by increased remodeling and refurbishing of retail stores by major customers.

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#### Metal trading

World-wide metal trading activities showed a sales increase of 33% over 1975 and a 69% improvement in income. The increased market activity in 1976 provided more opportunities for profitable trading. Lower interest costs on the financing of inventories and increased agency and special sale activities all contributed to improved operations.

#### Coal mining

Coal mining operations had improved dollar volume sales due to increased tonnage shipped but reduced earnings principally because of lower selling prices and margins on spot market sales.

#### All other

The reduction in the 1976 charge to income shown as "All other" from the 1975 charge is due principally to the elimination of the costs of duplicate corporate functions and the expenses associated with the 1975 relocation of Cerro's corporate offices from New York to Chicago and to reduced interest charges in 1976 resulting from debt reductions and lower interest rates.

#### Income taxes

The reduction in the effective pro forma income tax rate attributable to pro forma income of continuing operations, from 46.2% in 1975 to 42.9% in 1976, is due principally to 1976 disposals of assets with higher income tax bases than financial statement bases.

#### Fourth quarter 1976

Sales in the fourth quarter of 1976 declined approximately \$5,000,000 or 3% from the third quarter 1976 level, as restated, and income from continuing operations after income taxes declined from \$13,294,000 in the third quarter to \$6,752,000 in the fourth quarter. These declines resulted from the write-downs of inventories to market values to reflect reductions in copper prices in the fourth quarter, the normal seasonal reduction in building product sales and income, a further decline in mining equipment sales and income from earlier levels and reduced sales and income from coal mining operations.

LS 000824

### Directors and Officers

Robert H. Cutler .....	Chairman, Illinois-California Express, Inc., a subsidiary of Cerro-Marmon Corporation
Thomas F. Githens* .....	Senior Vice President and Director Smith Barney, Harris Upham & Co., Inc. (investment banking)
Robert C. Gluth .....	Executive Vice President Cerro-Marmon Corporation
Lewis B. Harder* .....	Chairman (Chief Executive Officer) International Mining Corporation (mining and marine terminal operations)
George A. Jones .....	Executive Vice President Cerro-Marmon Corporation
G. Willing Pepper* .....	Chairman of the Board The Institute for Cancer Research (non-profit research organization)
Jay A. Pritzker .....	Chairman of the Board Cerro-Marmon Corporation
Robert A. Pritzker .....	President Cerro-Marmon Corporation
Alan Wolfley .....	Chairman of the Board Inconcoal Corporation (coal trading)
Frederick J. Manning .....	Treasurer Cerro-Marmon Corporation
Thomas L. Seifert .....	Secretary and Legal Counsel Cerro-Marmon Corporation
John Spevacek .....	Controller Cerro-Marmon Corporation

\* Members of Cerro-Marmon's audit committee.

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**CERRO - MARMON CORPORATION**

CORPORATE HEADQUARTERS: 39 SOUTH LaSALLE STREET • CHICAGO, ILLINOIS 60603 • TELEPHONE (312) 372-9500

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20540

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended June 30, 1976 Commission File Number 1-7285

Casco-Macdon Corporation

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

52-104-5483

(I.R.S. Employer  
Identification No.)

31 South LaSalle Street, Chicago, Illinois

(Address of principal executive offices)

60603

(Zip code)

Registrant's telephone number, including area code (312) 372-9500

Not applicable

Former name, former address and former fiscal year, if changed  
since last report.

Indicate by check mark whether the registrant (1) has filed all  
reports required to be filed by Section 13 or 15 (d) of the Securities  
Exchange Act of 1934 during the preceding 12 months (or for such  
shorter period that the registrant was required to file such reports),  
and (2) has been subject to such filing requirements for the past 90  
days.

Yes x No     

Indicate the number of shares outstanding of each of the issuer's  
classes of common stock, as of the close of the period covered by  
this report.

5,000,000 shares of Common Stock were issued and outstanding  
as at June 30, 1976.

LS 000827

GERARD-JAMES COMPANY

CONDENSED CONSOLIDATED BALANCE SHEET (NOTES 1, 2 AND 3)  
(Unaudited)

June 30, 1975  
(In thousands of dollars)

ASSETS

Current Assets:

Cash	\$ 27,865
Marketable securities, less allowance of \$2,242	17,249
Receivables, less allowance of \$3,001	127,151
Inventories (Note 4)	174,010
Other current assets	<u>9,855</u>

Total Current Assets 355,140

Notes due from Chile	4,323
Real estate subsidiaries (Notes 3 and 5)	1,438
Property, plant and equipment, less accumulated depreciation of \$32,229	127,447
Other assets	<u>14,703</u>
	<u>\$ 504,051</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:

Notes payable	\$ 13,322
Current maturities of long-term obligations	15,233
Accounts payable	57,668
Income taxes (Note 6)	20,073
Accrued liabilities	<u>38,224</u>

Total Current Liabilities 149,520

Long-term debt (Note 7)	115,995
Lease-purchase obligations (Note 7)	17,499
Other noncurrent amounts	10,811
Commitments and contingent liabilities (Notes 6 and 8)	-

293,825

Stockholders' Equity: (Notes 7 and 9)

Preferred stock (liquidation preference and redemption value of \$95,149)	89,906
Common stock	5,000
Other paid-in capital	10,493
Retained earnings	<u>104,827</u>

Total Stockholders' Equity 210,225

\$ 504,051

See accompanying condensed notes LS 000828

CERRO-VANSON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF INCOME (NOTES 1, 2 AND 3)  
(Unaudited)

Three Months Ended June 30, 1976 and 1975  
(In thousands of dollars)

	<u>Historical</u>		<u>Pro Forma</u>
	<u>1976</u>	<u>1975</u>	<u>1975</u>
Revenues:			
Net sales	\$246,770	\$ 72,820	\$130,162
Miscellaneous - net	3,649	1,113	4,401
	<u>250,419</u>	<u>73,933</u>	<u>184,563</u>
Costs and expenses:			
Cost of products sold	208,055	58,490	147,907
Selling and administrative	16,118	6,974	19,303
Interest	3,616	1,949	4,085
	<u>227,789</u>	<u>67,413</u>	<u>171,295</u>
Income before amounts shown below	22,630	6,520	13,268
Income taxes (Note 6)	<u>(11,009)</u>	<u>(3,487)</u>	<u>(4,987)</u>
Income before equity in net income of Cerro	11,621	3,033	8,281
Equity in net income of Cerro	<u>-</u>	<u>2,524</u>	<u>-</u>
Net income	11,621	5,557	8,281
Net income applicable to preferred stock (Note 10)	<u>(2,557)</u>	<u>-</u>	<u>(2,557)</u>
Net income applicable to common stock	<u>\$ 9,064</u>	<u>\$ 5,557</u>	<u>\$ 5,724</u>

See accompanying condensed notes.

LS 000829

CERRO-CARROT CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF INCOME (NOTES 1, 2 AND 3)  
(Unaudited)

Six Months Ended June 30, 1976 and 1975  
(In thousands of dollars)

	<u>Historical</u>		<u>Pro Forma</u>	
	<u>1976</u>	<u>1975</u>	<u>1976</u>	<u>1975</u>
Revenues:				
Net sales	\$448,702	\$139,936	\$540,770	\$421,762
Miscellaneous - net	4,861	1,349	7,116	11,220
	<u>453,563</u>	<u>141,285</u>	<u>547,886</u>	<u>432,982</u>
Costs and expenses:				
Cost of products sold	386,265	110,972	465,951	353,974
Selling and administrative	26,488	13,807	32,370	35,923
Interest	5,786	4,170	7,277	8,550
	<u>418,539</u>	<u>128,949</u>	<u>505,598</u>	<u>399,447</u>
Income before amounts shown below	35,024	12,336	42,288	33,535
Income taxes (Note 6)	<u>(17,279)</u>	<u>(6,609)</u>	<u>(20,701)</u>	<u>(14,886)</u>
Income before equity in net income of Cerro	17,745	5,727	21,587	18,649
Equity in net income of Cerro	<u>1,782</u>	<u>5,819</u>	<u>-</u>	<u>-</u>
Net income	19,527	11,546	21,587	18,649
Net income applicable to preferred stock (Note 10)	<u>(3,558)</u>	<u>-</u>	<u>(5,114)</u>	<u>(5,114)</u>
Net income applicable to common stock	<u>\$ 15,969</u>	<u>\$ 11,546</u>	<u>\$ 16,473</u>	<u>\$ 13,535</u>

See accompanying condensed notes.

LS 000830

CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (NOTES 1, 2 AND 3)

(Unaudited)  
Six Months Ended June 30, 1976  
(In thousands of dollars)

	Preferred stock (Note 9)	Common stock (Note 9)	Other paid-in capital	Retained earnings	TOTAL
Balance at January 1, 1976	\$ -	\$ 1	\$ 12,027	\$ 88,858	\$100,835
Excess of par value of Cerro-Marmon common stock issued to GL over par value of Marmon common stock		4,999	(4,999)		-
Value of preferred stock issuable to Cerro stockholders	89,743		2,588		89,743
Contribution by GL (Note 8)					2,588
Elimination of Marmon deferred income tax applicable to its equity in undistri- buted net income of Cerro			877	(3,395)	377
Preferred dividends declared				(153)	(3,395)
Accrual of redemption value of preferred stock (Note 10)	163			19,527	19,527
Net income					-
Balance at June 30, 1976	\$ 89,906	\$ 5,000	\$ 10,493	\$104,827	\$210,226

LS 000831

See accompanying condensed notes.



CERRO-HARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CHANGES  
IN FINANCIAL POSITION (NOTES 1, 2 AND 3)  
(Unaudited)

Six Months ended June 30, 1976  
(In thousands of dollars)

Sources of working capital:	
Total provided by operations	\$ 28,681
Merger of Cerro at February 24,	
1976 (Note 3) -	
Preferred stock issuable	\$ 89,743
Harmon's basis in 45.33% of Cerro	80,028
Long-term debt assumed	89,252
Other - net	<u>12,815</u>
	271,838
Less cost assigned to noncurrent	
assets	<u>107,018</u>
Total provided by merger of Cerro	164,820
Proceeds from long-term obligations	1,325
Decrease in Chilean notes	<u>9,208</u>
Total working capital provided	204,034
Dispositions of working capital:	
Additions to property, plant and	
equipment	\$ 10,317
Reduction in long-term obligations	
(Note 7)	38,351
Increase in other assets	3,884
Payment of dividends	3,395
Other - net	<u>3,757</u>
Total working capital used	<u>59,704</u>
Increase in working capital	144,330
Working capital at January 1, 1976	<u>62,290</u>
Working capital at June 30, 1976	<u>\$ 206,620</u>

See accompanying condensed notes.

LS 000832

CERRO-MARMON CORPORATION

CONDENSED NOTES TO THE  
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The accompanying condensed consolidated financial statements, which are for an interim period, do not include all disclosures provided in annual financial statements. Reference is made to the March 31, 1976 condensed consolidated financial statements and related notes thereto included in Cerro-Marmon's Form 10-Q for the period ended March 31, 1976.

1. Organization

Cerro-Marmon Corporation (Cerro-Marmon) was incorporated on November 21, 1975 and was inactive until February 24, 1976. On that date (1) Cerro-Marmon issued 5 million common shares to GL Corporation (GL) for all of the outstanding common shares of The Marmon Group, Inc. (Michigan) (Marmon), in a transaction accounted for as if it was a pooling of interests, and (2) Cerro-Marmon issued preferred stock to holders of Cerro Corporation (Cerro) common stock, other than Marmon, on a share-for-share basis, and Cerro was merged into Cerro-Marmon in a transaction accounted for as a purchase (Note 3).

2. Basis of the financial statements and consolidation policy

The consolidated financial statements for periods prior to February 25, 1976 consist of the historical financial statements of Marmon and all subsidiaries, including Marmon's 45.33% interest in Cerro accounted for on the equity method.

The consolidated financial statements as of dates and for periods subsequent to February 24, 1976 include the accounts of Cerro-Marmon and all subsidiaries (including the former Cerro businesses and subsidiaries) except the real estate subsidiaries (principally Leadership Housing, Inc.) (Leadership) (see Note 5) and certain immaterial foreign subsidiaries.

The pro forma statements of income consist of (1) the historical statements of Marmon and Cerro for the 1975 periods and the period January 1, 1976 to February 24, 1976, adjusted on a pro forma basis to give effect to the adjustments resulting from the merger of Cerro into Cerro-Marmon, as if the merger had been completed on January 1, 1976 and (2) the historical statements of Cerro-Marmon for the period subsequent to February 24, 1976.

The accompanying condensed consolidated financial statements include all adjustments which, in the opinion of management, are necessary for a fair presentation of the consolidated financial position, results of operations and changes in financial position.

LS 000833

### 3. Acquisition of Cerro

Effective August 1, 1974, Marmon acquired a 45.33% equity interest in Cerro, at a total cost of \$57,846,000. On February 24, 1976, Cerro was merged into Cerro-Marmon (Note 1). Pursuant thereto, the former common stockholders of Cerro, other than Marmon, became entitled to receive one share of Cerro-Marmon \$2.25 Cumulative Series A Preferred Stock (Note 9) for each share of Cerro common stock. The preferred shares issuable were valued by the Board of Directors of Cerro-Marmon at \$20.75 per share, based on an estimated fair value of the preferred stock determined when the exchange ratio was approved by the Board of Directors of Cerro.

The above described transactions have been accounted for as a purchase of Cerro by Cerro-Marmon. Accordingly, the net assets of the businesses formerly conducted by Cerro included in the consolidated balance sheet of Cerro-Marmon reflect amounts determined after giving effect to a preliminary allocation of Cerro-Marmon's purchase cost to such net assets. The allocations of purchase cost to Cerro's net assets were made as of August 1, 1974 as to the 45.33% interest in Cerro acquired as of that date and as of February 24, 1976 as to the 54.67% interest in Cerro acquired as of that date. The effect of the purchase cost allocation was to significantly reduce the amounts at which Cerro's historical consolidated net assets are included in the Cerro-Marmon consolidated balance sheet. THE RESULTS OF SUCH PRELIMINARY ALLOCATION ARE SUBJECT TO CHANGE TO REFLECT ADDITIONAL INFORMATION OBTAINED AND REALIZATION OF ANY BENEFITS FROM CERRO'S PRIOR INCOME TAX LOSSES.

The purchase cost allocations had the effect of significantly increasing the net earnings of Cerro-Marmon. This effect resulted principally from (1) reductions in depreciation and amortization relating to the reduced carrying value of property, plant and equipment and intangible assets and (2) elimination of losses from the real estate operations, see Note 5. SUCH AMOUNTS ARE SUBJECT TO RETROACTIVE ADJUSTMENT TO REFLECT THE EFFECTS OF ANY CHANGES MADE TO THE ALLOCATION OF PURCHASE COST AND THE EFFECT OF ANY REALIZATION OF BENEFITS FROM CERRO'S PRIOR INCOME TAX LOSSES.

For purposes of determining Marmon's equity in Cerro's net earnings, losses of real estate subsidiaries were adjusted to reflect the effects of the purchase cost allocation to the investment in Leadership. These adjustments in the six months ended June 30, 1975 consisted principally of the elimination of direct losses from realty sales, inventory write-downs and write off of goodwill (no such adjustments were required in the period January 1, 1976 to February 24, 1976). Effective February 25, 1976 all net gains or losses from the real estate subsidiaries' operations and from intercompany transactions with the real estate subsidiaries (including income taxes related thereto), for a two-year period (or appropriate shorter period), will be credited or

LS 000834

changed to a reserve for losses (Note 5). This change in estimate increased Cerro-Marmon's consolidated net income for the period February 24, 1976 to June 30, 1976, by approximately \$1,500,000.

The treatment followed by Marmon for purposes of determining its equity in Cerro's earnings was deemed appropriate based on information known at the time of adoption. However, the present status of the real estate subsidiaries and the uncertainties relating to their operations, as discussed in Note 5, indicate that the treatment adopted by Cerro-Marmon is more reflective of the present circumstances and will result in consolidated operating results that are more reflective of the effects of the purchase of Cerro at an amount substantially less than Cerro's historical net asset value.

#### 4. Inventories

The last-in, first out (LIFO) cost of inventories (approximately 24% of inventories included in the accompanying condensed consolidated balance sheet) valued under this method was approximately \$27 million less than the approximate current cost (determined principally on the basis of standard costs) of these inventories. It is not practicable to classify inventories by stage of production.

#### 5. Real estate subsidiaries

Effective April 1, 1976, certain of the assets of Leadership were transferred to The Housing Group, Inc., a newly formed subsidiary of Cerro-Marmon. Cerro-Marmon's investment in these nonconsolidated real estate subsidiaries is included in the condensed consolidated balance sheet at Cerro-Marmon's equity in the net assets of such subsidiaries, less a reserve for future losses. Details of such investment at June 30, 1976 follow, in thousands:

Investment - net	\$ 36,440
Less reserve for losses	<u>35,002</u>
Net carrying value	<u>\$ 1,438</u>

Changes in the reserve from February 25, 1976 to June 30, 1976 were as follows, in thousands:

Balance at February 25, 1976	\$ 35,480
Net loss for the period, as reported by the real estate subsidiaries	(3,297)
Other - net	<u>1,819</u>
Balance at June 30, 1976	<u>\$ 35,002</u>

Condensed combined statements of operations of the real estate subsidiaries, as reported by these subsidiaries follow, in thousands:

LS 000835

CONDENSED SUMMARY OF OPERATIONS

	Three months ended <u>June 30, 1975</u>	Period February 25, 1975 to <u>June 30, 1975</u>
Sales	\$ 10,487	\$ 12,364
Interest and other revenue	<u>1,283</u>	<u>2,059</u>
	<u>11,775</u>	<u>14,423</u>
Costs and expenses:		
Cost of sales	10,294	12,098
Selling and administrative	1,715	2,320
Interest, net of capitalized	<u>2,165</u>	<u>3,302</u>
Net loss	<u>\$ 2,399</u>	<u>\$ 3,297</u>

On August 13, 1975, management stated its intention to reduce substantially the business, operations and debt levels of the real estate subsidiaries through an orderly liquidation of inventories designed to minimize losses. It is expected that, after this reduction is completed, the total assets would be less than half of the total assets at December 31, 1974. As a result of the condition of the real estate market existing in the United States generally, and in Florida in particular, an orderly liquidation of inventories designed to preserve corporate assets is likely to take several years. This liquidation may take place while adverse market conditions prevail. To the extent the reduction results in the disposition of inventories other than in the normal course of business and during a period in which adverse market conditions prevail, the estimated net realizable value may be adversely affected by an undeterminable amount.

The real estate subsidiaries have historically utilized their own sales transactions, as well as sales of comparable land and improvements of others, as one of the primary factors in the determination of estimated net realizable value. Based upon information available in 1975, a determination of net realizable value was made which resulted in provisions for writedown of inventories at December 31, 1975. However, the decline in comparable transactions together with adverse market conditions and the inventory reduction plan mentioned above have created significant uncertainties with respect to the determination of estimated net realizable value. Accordingly, uncertainties are created as to the amount and timing of the ultimate realization upon disposition of land and improvement inventories carried on the books of the real estate subsidiaries (\$72,828,000 at June 30, 1975).

LS 000836

The estimated net realizable value of unimproved property (\$39,306,000 at June 30, 1975) held by the two joint ventures in which Leadership is a participant with the Pritzker Trusts (the beneficiaries of the Pritzker Trusts are members of the Pritzker family, including J. A. Pritzker and R. A. Pritzker, principal officers and directors of Cerro-Marmon. The Pritzker family is also the beneficial owner of CL) is subject to the same uncertainties as described in the preceding paragraph. While Leadership has no investment in these particular ventures, it is contingently liable to lenders with respect to approximately \$13.5 million of notes payable of the ventures at June 30, 1976.

Events of Default existed at June 30, 1975 under certain of the covenants in the Loan Agreement of Leadership. It is anticipated that additional Events of Default may occur in 1976 as a result of continuing unprofitable operations, which may be affected by the outcome of litigation involving certain receivables aggregating \$1,565,000, the ultimate collectibility of which can not presently be determined. If Events of Default occur, the Loan Agreement provides that, upon notification from the principal lenders, the debt covered thereby would become due and payable. The existing Loan Agreement is currently being renegotiated, the outcome of which cannot be determined at this time.

Cerro financially supported the operations of Leadership prior to the merger and on June 10, 1976 Cerro-Marmon entered into a \$2,000,000 non-revolving secured working capital loan agreement to be used as funds are needed, to bear interest at the prime rate. As at June 30, 1976, \$1,000,000 had been utilized. Interest is payable monthly with the principal to be paid on or before December 31, 1976. No decision has been reached as to how long Cerro-Marmon will continue its support if Leadership's current operating losses continue. The Loan Agreement does not provide adequate support during the orderly liquidation period described above, or if the principal lenders withdraw their support. Cerro-Marmon also has legally binding commitments in connection with surety bonds (approximately \$34 million at June 30, 1976) guaranteeing performance under certain construction contracts. A substantial amount of work has been performed under such contracts, but it is not possible to predict the cost to Cerro-Marmon, if any, under the surety bonds.

Notes payable at June 30, 1976 consist of the following, in thousands:

Obligations to banks:	
Leadership*	\$ 43,713
Housing Group, Inc.	604
Real estate mortgages, 7% to prime plus	
5.5%, due to 2011	43,554
Unsecured notes, 6-8%, due to 1982	<u>2,660</u>
	<u>\$ 90,531</u>

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as follows: pursuant to an Amended and Restated Loan Agreement ("Agreement") dated April 1, 1975 and evidenced by a \$44,369,000 note due April 1, 1977, subject to acceleration as provided in the Agreement. The note bears interest at the rate of 1-1/2% above the Bank's Alternate Base Rate. Two percent of such interest is payable monthly in cash and the difference between the 2% and the 1-1/2% over the Bank's Alternate Base Rate is accrued until the total accrued interest equals \$5,000,000, after which Leadership shall pay to the Bank in cash the full 1-1/2% above the Bank's Alternate Base Rate. The balance of the accrued interest shall be paid at maturity.

The Agreement provides, among other things, for maintenance of minimum tangible net worth, limitations on the purchase of real estate, the sale of certain assets and investments in new properties or joint ventures. In addition, Leadership is required to maintain certain collateral coverage ratios and meet specified cash flow objectives (based on quarterly projections) which, if not met, could be deemed Events of Default by the Bank.

Generally, loans under the Agreement are secured by the assignment of notes, mortgages and deeds of trust; a pledge of the capital stock of one of Leadership's wholly-owned subsidiaries; the granting to the Bank of a first mortgage on most of Leadership's unencumbered real estate; an agreement to assign notes and mortgages acquired after the closing date; an agreement to grant first mortgages on real estate acquired after the closing date; the assignment of Leadership's beneficial interest in two land trusts; an assignment of its interest in a joint venture and its right to cash distributions from its other two joint ventures; the assignment of Excess Cash Proceeds, as defined, if any, from any future sale of Tamarac Utilities, Inc. by Cerro-Marmon to third parties; and the assignment to the Bank of all of Leadership's rights in a Tax Allocation Agreement dated July 31, 1972. In addition, Leadership has assigned a purchase money note of Cerro-Marmon (\$3,469,000 at June 30, 1976) with all principal prepayments thereon to be applied to the Bank's note. Certain amounts due to Cerro-Marmon by Leadership are subordinated to the Bank's claims.

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6. Income Taxes

Cerro-Marmon is to be included in the consolidated federal income tax return of GL and, prior to February 25, 1976, Marmon was included in the GL consolidated federal income tax return. Pursuant to a formal tax sharing agreement with GL, federal income taxes of Cerro-Marmon will be determined, in general, as if the former Cerro affiliated tax group and the Marmon affiliated tax group each filed separate consolidated tax returns. Prior to February 25, 1976, federal income taxes of Marmon were determined, in general, as if Marmon and its domestic subsidiaries filed a separate consolidated tax return. Federal income taxes so determined have been paid periodically to GL by Marmon and will be paid periodically to GL by Cerro-Marmon except that (1) the former Cerro affiliated tax group shall not be required to make any tax sharing payments during any taxable period in which Cerro-Marmon has not currently paid all prescribed dividends or made sinking fund payments on its Series A preferred stock and (2) during all other taxable periods the members of the former Cerro affiliated group shall retain, without restriction, 50% of any tax sharing payments that would be due to any member of the GL affiliated group.

As a member of the GL consolidated federal income tax group, Cerro-Marmon (and Marmon prior to February 25, 1976) is contingently liable for the federal income taxes of the other members of the group. GL has agreed to indemnify Cerro-Marmon (and Marmon) for any federal income taxes attributable to other members of the group.

Federal income taxes accrued but not yet paid to GL or payments to GL in excess of amounts accrued are included as income taxes or refundable income taxes in the consolidated balance sheet. Interest at 115% of the bank's prime rate is paid or received on differences between payments made and payments due.

On January 22, 1974, the Internal Revenue Service advised Cerro by a private ruling letter that it considered the Cerro de Pasco expropriation loss to have resulted from a compulsory or involuntary conversion of the stock of Cerro de Pasco and that the loss qualified as an ordinary loss which could be carried over and applied against the Cerro affiliated group income for as long as ten years to the extent not consumed during the taxable year in which it arose.

By letter dated May 12, 1976, the Internal Revenue Service advised Cerro-Marmon that the January 22, 1974 ruling letter was being retroactively revoked with respect to the conclusion that the loss was an involuntary conversion of the stock of Cerro de Pasco and held that the transaction will be treated as an expropriation of assets.

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Accordingly, Cerro-Marmon may be required to establish the tax basis of the Cerro de Pasco assets which were expropriated. The Company believes such adjusted basis can be established, however, the proof of basis of assets (as compared to basis in stock) may be more difficult. The retroactive reversal of the January 22, 1974 ruling letter could also affect the technical elements for substantiating the continued availability of the net operating loss carryover derived from the expropriation loss, which availability may be determined under Section 382(a) of the Code. Cerro-Marmon believes and has been advised by its outside tax counsel that the net operating loss carryover from Cerro should not be subject to disallowance under Section 382(a).

At June 30, 1976, Cerro-Marmon had losses (losses of Cerro relating to the expropriation of Cerro de Pasco) which could result in reductions up to approximately \$29,000,000 in future federal income taxes. Realization of the benefits of such losses will not directly effect the reported net income of Cerro-Marmon as any benefits realized will be credited to balance sheet accounts.

Income tax expense (benefit) consists of the following, in thousands:

	<u>Historical</u>	
	<u>Three months</u>	<u>Six months</u>
	<u>Ended</u>	<u>Ended</u>
	<u>June 30, 1976</u>	<u>June 30, 1976</u>
United States:		
Current	\$ 2,894	\$ 7,610
Deferred	(164)	(33)
Provision in lieu of		
income taxes	6,190	6,705
Foreign:		
Current	231	65
Deferred	45	156
State	<u>1,813</u>	<u>2,776</u>
	\$ <u>11,009</u>	\$ <u>17,279</u>

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7. Long-term debt and lease-purchase obligations

Details of long-term debt at June 30, 1976 follow, in thousands:

Notes due to banks, 1/2% above prime, due to 1981	\$ 32,000
Notes due to institutions, 6%-6-3/8% (discounted to an effective rate of 9.5%), due to 1987	25,900
Notes due to corporations, 9-1/4%, due 1977-1987	35,000
Notes due to individuals, 5% (discounted to an effective rate of 9%), due to 1980	5,746
Subordinated debentures, 7%, due to 1990	3,864
Subordinated notes, 12%, due to 1984	3,260
Other	10,225
	<u>\$ 115,995</u>

The various debt agreements impose certain restrictions on Cerro-Marmon and certain subsidiaries (including Marmon), including restrictions on the payment of cash dividends and the repurchase of capital stock. Pursuant to provisions of the most restrictive of the agreements, Cerro-Marmon had approximately \$22,000,000 available for the payment of cash dividends and the repurchase of capital stock at June 30, 1976.

Details of lease-purchase obligations at June 30, 1976 follow, in thousands:

3.5 % to 6.8 %, due to 1988	\$ 4,334
5.25% to 9.5 %, due to 1993	6,800
5% to 7.5 %, due to 1994	5,115
6% to 8.25%, due to 1990	1,250
	<u>\$ 17,499</u>

Scheduled maturities of the long-term debt and lease-purchase obligations in the five calendar years 1977-1981 are \$20,687,000 in 1977, \$20,855,000 in 1978, \$20,579,000 in 1979, \$17,262,000 in 1980 and \$10,011,000 in 1981. In addition, the notes due to banks included in long-term debt require aggregate annual prepayments (maximum of \$6,000,000 per year) beginning April 1, 1977 based on the consolidated net income of Marmon.

Certain of the long-term debt and all of the lease-purchase obligations are secured by certain property, plant and equipment.

8. Litigation

Cerro-Marmon is subject to the possible effects of various litigation commenced against several defendants, including GL, Cerro and Marmon, in 1975 and 1976, relating principally to the purchase of Cerro stock by Marmon in 1974 and the merger

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of Cerro into Cerro-Marmon, all of which actions are pending in the United States District Court for the Southern District of New York. These actions allege violations of the anti-fraud provisions of the federal securities laws and common law and derivative claims, and various wrongdoings on the part of the various defendants and request various reliefs.

In April 1976, the parties involved in several of the actions agreed to two stipulations of settlement, subject to court approval, whereby (1) GL will pay for the benefit of the defined plaintiff classes (former Cerro common stockholders) up to \$2,550,000 for settlement of the actions, plaintiff's counsels' fees and expenses and other costs, and (2) certain of the defendants, not including Marmon, will pay to Cerro-Marmon \$750,000 (including amounts to be paid for plaintiff's counsels' fees and expenses) for settlement of the derivative claims.

The cost to GL of the proposed payments in (1) above has been reflected in the accompanying financial statements as a contribution to the capital of Cerro-Marmon and as an additional cost of the Cerro common stock acquired. The amount to be received by Cerro-Marmon for the settlement of the derivative claims will be reflected in the Cerro-Marmon financial statements upon receipt of the funds with usage limited to payment of regular dividends to the preferred stockholders.

A hearing was held in May 1976 for approval by the court of the settlement terms and action by the court is presently pending.

The above described proposed settlement does not include a purported class action relating to the merger of Cerro into Cerro-Marmon filed in February 1976 in New York State Court against several defendants including Marmon, Cerro and Cerro-Marmon. This action is based on several alleged causes of action, and asks that there be an injunction against a merger between Cerro and Cerro-Marmon that will divest the public stockholders from a residual equity position, or on terms other than as are presented to the court and determined by it to be fair and for costs including attorneys' fees to the plaintiffs. The complaint alleges (1) no corporate benefit for Cerro in which the public stockholders will share, (2) that the merger will "freeze out" the plaintiff class from Cerro's "residual equity", (3) that the preference stock will not share in the residual equity or possible future growth or improvements in Cerro's financial position, and (4) that certain defendants (some of whom are officers and/or directors of Marmon and Cerro-Marmon) breached their fiduciary duties owed to the public stockholders. Other causes of action allege breaches of fiduciary duties by certain defendants (some of which are officers and/or directors of Cerro-Marmon and Marmon) relating to (1) a \$25,000,000 capital contribution to Marmon by Cerro-Marmon, (2) the adequacy of the payment for the Cerro

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common shares which is being received by the plaintiff class, (3) preparation of the documentation with respect to the merger and (4) misappropriation of the benefits of the merger to be shared by the plaintiff class. In February 1976, the injunction to stay the merger was denied; this denial has been appealed. An action, substantially similar in all respects to the February 1976 action discussed above, except that it also alleges violation of the anti-fraud provisions of federal securities law, was subsequently filed in Federal Court in New York.

In the opinion of counsel, the claims in these class actions will not be sustained.

Other legal actions against Cerro-Marmon or its subsidiaries are not expected to materially effect Cerro-Marmon's consolidated financial statements.

#### 9. Capital stock

The authorized capital stock of Cerro-Marmon consists of 10,000,000 shares of \$1 par value preferred stock and 10,000,000 shares of \$1 par value common stock.

##### Preferred -

At June 30, 1976, 4,324,970 shares of preferred stock were issuable which includes such shares, not as yet determined, applicable to former Cerro stockholders who will be paid in cash pursuant to their perfected dissenters' rights. These shares, designated "\$2.25 Cumulative Series A Preferred Stock", are entitled among other things, to dividends at the annual rate of \$2.25 per share on a cumulative basis, a liquidation preference of \$22 per share plus accrued dividends, and are voting (one vote per share). All or part of the Series A stock may be redeemed by Cerro-Marmon on or after April 1, 1981 at \$22 per share plus accrued dividends. Commencing in 1982, 6-2/3% of the Series A shares originally issued are to be redeemed annually until all such shares are redeemed or acquired by Cerro-Marmon. Pursuant to terms of the proposed settlement of certain litigation (Note 8), the annual dividend rate on the Series A stock will be increased to \$2.35 per share beginning 1981.

##### Common -

At June 30, 1976, 5,000,000 shares of common stock were issued and outstanding (entitled to four votes per share). Further, pursuant to terms of the proposed settlement of certain litigation (Note 8), no payments can be made with respect to the common stock until consolidated stockholders' equity is \$10,000,000 greater than such equity on February 24, 1976. As a result of the above, no amounts would be available at June 30, 1976 for payments with respect to the common stock.

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10. Dividends applicable to preferred stock

The amount shown in the consolidated statement of income for the six months ended June 30, 1975 consists of \$3,395,000 of dividends applicable to the Series A preferred stock and \$153,000 for the accrual of the excess of redemption value over the value of the Series A preferred stock issuable, both for the period February 25, 1975 to June 30, 1975. For the quarter ended June 30, 1975 the comparable figures are \$2,432,000 for dividends and \$125,000 for accrual of excess of redemption value over the book value assigned to the preferred stock.

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# MANAGEMENT'S DISCUSSION AND ANALYSIS OF EARNINGS

The comparability of the accompanying historical condensed consolidated statement of income is significantly affected by the merger of Cerro Corporation into Cerro-Harmon Corporation on February 24, 1976 as described in the notes to the condensed financial statements.

Therefore, the following comments relate to a comparison of the results of operations of Cerro-Harmon on a pro forma basis for all periods except for the quarter ended June 30, 1976.

Details of net sales and income before income taxes are presented below, in thousands of dollars:

	1976			1975	
	Quarter Ended		Year to date	Quarter Ended	
	3-31	6-30		6-30	6-30
<u>Net Sales:</u>					
Manufacturing					
Cerro	\$182,874	\$128,345	\$311,219	\$ 71,673	\$211,009
Harmon	75,974	75,542	151,516	72,820	139,936
Total	258,848	203,887	462,735	144,493	350,945
Mining	14,645	21,681	36,326	18,329	36,581
Trucking	20,507	21,202	41,709	17,340	34,236
Total	<u>\$294,000</u>	<u>\$246,770</u>	<u>\$540,770</u>	<u>\$180,162</u>	<u>\$421,762</u>
<u>Income before income taxes:</u>					
Manufacturing					
Cerro	\$ 9,010	\$ 10,198	\$ 19,208	\$ 3,243	\$ 9,427
Harmon	10,111	9,431	19,542	8,412	16,835
Total	19,121	19,629	38,750	11,655	26,262
Mining	1,099	2,855	3,954	4,219	11,211
Trucking	996	1,617	2,613	1,513	2,307
Corporate admin- istrative, int. and other exp. less misc. revenues	<u>(1,558)</u>	<u>(1,471)</u>	<u>(3,029)</u>	<u>(4,119)</u>	<u>(6,245)</u>
<u>Income before income taxes:</u>	<u>\$ 19,658</u>	<u>\$ 22,630</u>	<u>\$ 42,283</u>	<u>\$ 13,268</u>	<u>\$ 33,535</u>

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## Auto Division

### Cumco

Net sales of \$128,345,000 for the second quarter of 1976 were down by \$54,529,000 from the first quarter of 1976 and up 7% or \$36,572,000 from the second quarter of 1975. The first quarter of 1975 included a special metal commodity sale of approximately \$72,000,000 which, if excluded, would show all other manufacturing sales up 18% in the second quarter vs. the first quarter. 1976 continued to benefit from the trend in increased copper prices and demand while 1975 suffered from poorer economic conditions and strikes at two major plants.

Pretax income in the second quarter of 1976 was \$10,198,000; a \$1,188,000 improvement over the first quarter of 1976 and a \$6,955,000 improvement compared to the second quarter of 1975. The increase is attributable to higher profits on increased sales compared to the strike depressed 1975 levels.

Net sales and income for the first half of 1976 were greater than the comparable 1975 period by \$100,210,000 and \$9,781,000, respectively, due principally to increases in demand and basic metal prices in 1976 over the poorer economic conditions and strikes in 1975.

### Marmon

Net sales for the second quarter of 1976 were about equal to the first quarter 1976 level and about 4% ahead of the second quarter of 1975. Sales declines of mining equipment in the second quarter of 1976 were offset by improvements in sales of automotive and building products.

The decline in pretax income of \$680,000 in the second quarter of 1976 compared to the first quarter is primarily attributable to reduced profits in mining equipment due to lower sales. The increase in pretax income of about 12% in the second quarter of 1976 as compared to the 1975 quarter is principally a result of improved profits in automotive and building product lines partially offset by lower mining equipment profits.

Net sales for the first half of 1976 were about 8% higher than the 1975 period as a result of improvements in sales of automotive and building products which also accounted for a majority of the increase in pretax income

### Mining

Sales of \$21,681,000 for the second quarter of 1976 were up \$7,036,000 from the first quarter of 1976 and \$3,352,000 higher than the second quarter of 1975. (after reclassification

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of 1975 freight charges primarily included in sales and now reported as a cost recovery.) A portion of the increase in sales resulted from the acquisition of Stott Coal Co. in August 1975 and Jenner Mining in May 1975.

Continuing significant reductions in selling prices, which began in the first quarter of 1975, and delays of shipments under a long-term contract adversely impacted pretax income from \$2,855,000 in the second quarter of 1976 compared to \$4,219,000 in the second quarter of 1975. Pretax profits in the first quarter of 1976 compared to the first quarter were higher due to tonnage shipped.

Sales for the first half of 1976 were \$36,326,000 compared to \$36,581,000 in the first half of 1975. Reduced selling prices and demand were the major factors for this flatness. Pretax income of \$3,954,000 compared to \$11,211,000 in 1975 also reflects lower sales prices and resulting in reduced margins.

#### Trucking

Operating revenues at \$21,202,000 for the second quarter were 33% higher than the first quarter of 1976 and 22% higher than the second quarter of 1975. Rate increases in the fall of 1975 and April 1976 are the principal cause for this improvement.

Pretax income of \$1,617,000 for the second quarter of 1976 was up from the \$996,000 for the first quarter of 1976 and \$1,513,000 for the second quarter of 1975. The improved result reflects the effect of rate increases partially offset by higher operating and maintenance costs in 1976.

Revenues of \$41,709,000 for the first half of 1976 compares to \$34,236,000 in 1975. Rate increases are again the principal cause of this increase. Pretax income at \$2,613,000 for the first half of 1976 compares to \$2,307,000 in 1975. Increased operating and maintenance costs held income increases to the general trend of revenue increases.

#### Real estate subsidiaries

For reasons discussed in Notes 3 and 5 to the consolidated financial statements, no amounts relating to the real estate operations are included in the accompanying consolidated statements of income. Sales were \$10,487,000 for the second quarter of 1976 compared with \$7,661,000 for the first quarter of 1976 and \$8,386,000 for the second quarter of 1975.

A loss continues to be incurred based on historical financial statements which do not reflect any purchase cost allocation adjustments resulting from the purchase of Cerro by Cerro-Marmon. Such loss before income taxes was approximately \$2,400,000.

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In the second quarter of 1976 compared with a loss of approximately \$2,000,000 in the first quarter of 1976. Losses are expected for the balance of the year.

Corporate administrative, interest and other expense, less miscellaneous revenues

Net costs for the second quarter of 1976 were \$1,471,000 vs. \$1,550,000 in the first quarter and \$4,119,000 in the second quarter of 1975. The principal reasons for this reduction from the 1975 amount are the reduction of home office costs and reduced interest expense as a result of a reduction of short- and long-term debt, partially offset by a reduction in investment income.

Six months' net costs were \$3,029,000 in 1976 compared to \$6,245,000 in 1975. This reduction resulted principally for the reasons noted above.

OTHER FINANCIAL INFORMATION

No reports on Form S-K were required to be filed for the three months ended June 30, 1976 with respect to any material unusual charges or credits to income or a change in independent accountants.

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Sales of unregistered securities (debt or equity)

There were no sales of unregistered securities as defined in Section 2(1) of the Securities Act of 1933 during the three months ended June 30, 1976.


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SIGNATURES

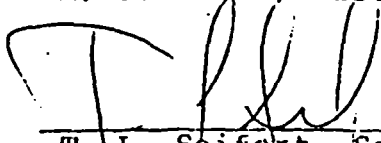
Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CERRO-MARMON CORPORATION  
(Registrant)

DATE: August 12, 1976

  
\_\_\_\_\_  
R. C. Gluth, Vice-President

DATE: August 12, 1976

  
\_\_\_\_\_  
T. L. Seifert, Secretary

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended September 30, 1976 Commission File Number 1-7285

Cerro-Marmon Corporation

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

52-104-5483

(I.R.S. Employer  
Identification No.)

39 South LaSalle Street, Chicago, Illinois

(Address of principal executive offices)

60603

(Zip code)

Registrant's telephone number, including area code (312) 372-9500

Not applicable

Former name, former address and former fiscal year, if changed  
since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No     

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of the period covered by this report.

5,000,000 shares of Common Stock were issued and outstanding  
as at September 30, 1976.

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET (NOTES 1, 2 AND 3)  
(Unaudited)

September 30, 1976  
(In thousands of dollars)

ASSETS

Current Assets:

Cash	\$ 36,057
Marketable securities, less allowance of \$2,391	16,355
Receivables, less allowance of \$2,844	120,075
Inventories (Note 4)	189,110
Other current assets	<u>8,508</u>

Total Current Assets 370,205

Notes due from Chile	1,391
Real estate subsidiaries (Notes 3 and 5)	1,223
Property, plant and equipment, less accumulated depreciation of \$36,138	121,973
Other assets	<u>15,663</u>
	<u>\$ 510,455</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:

Notes payable	\$ 22,635
Current maturities of long-term obligations (Note 7)	35,933
Accounts payable	55,995
Income taxes (Note 6)	28,120
Accrued liabilities	<u>35,356</u>

Total Current Liabilities 178,039

Long-term debt (Note 7)	83,745
Lease-purchase obligations (Note 7)	17,311
Other noncurrent amounts	10,900
Commitments and contingent liabilities (Notes 6 and 8)	<u>-</u>

289,995

Stockholders' Equity: (Notes 7 and 9)

Preferred stock (liquidation preference and redemption value of \$95,149)	90,028
Common stock	5,000
Other paid-in capital	10,493
Retained earnings	<u>114,939</u>

Total Stockholders' Equity 220,460

\$ 510,455

See accompanying condensed notes

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF INCOME (NOTES 1, 2 AND 3)  
(Unaudited)

Three Months Ended September 30, 1976 and 1975  
(In thousands of dollars)

	<u>Historical</u>		<u>Pro Forma</u>
	<u>1976</u>	<u>1975</u>	<u>1975</u>
Revenues:			
Net sales	\$246,528	\$ 68,327	\$196,529
Miscellaneous - net	<u>2,781</u>	<u>65</u>	<u>3,539</u>
	<u>249,309</u>	<u>68,392</u>	<u>200,068</u>
Costs and expenses:			
Cost of products sold	204,912	54,324	161,681
Selling and administrative	17,335	6,246	16,053
Interest	<u>3,291</u>	<u>2,016</u>	<u>4,230</u>
	<u>225,538</u>	<u>62,586</u>	<u>181,964</u>
Income before amounts shown below	23,771	5,806	18,104
Income taxes (Note 6)	<u>(11,105)</u>	<u>(3,346)</u>	<u>(8,724)</u>
Income before equity in net income of Cerro	12,666	2,460	9,380
Equity in net income of Cerro	<u>-</u>	<u>4,405</u>	<u>-</u>
Net income	12,666	6,865	9,380
Net income applicable to preferred stock (Note 10)	<u>(2,554)</u>	<u>-</u>	<u>(2,554)</u>
Net income applicable to common stock (Note 10)	<u>\$ 10,112</u>	<u>\$ 6,865</u>	<u>\$ 6,826</u>

See accompanying condensed notes.

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF INCOME (NOTES 1, 2 AND 3)  
(Unaudited)

Nine Months Ended September 30, 1976 and 1975  
(In thousands of dollars)

	<u>Historical</u>		<u>Pro Forma</u>	
	<u>1976</u>	<u>1975</u>	<u>1976</u>	<u>1975</u>
Revenues:				
Net sales.	\$695,230	\$208,263	\$787,298	\$618,291
Miscellaneous - net	7,642	1,414	9,897	14,759
	<u>702,872</u>	<u>209,677</u>	<u>797,195</u>	<u>633,050</u>
Costs and expenses:				
Cost of products sold	591,177	165,296	670,863	515,655
Selling and administrative	43,823	20,053	49,705	52,976
Interest	9,077	6,186	10,568	12,780
	<u>644,077</u>	<u>191,535</u>	<u>731,136</u>	<u>581,411</u>
Income before amounts shown below	58,795	18,142	66,059	51,639
Income taxes (Note 6)	<u>(28,384)</u>	<u>(9,955)</u>	<u>(31,806)</u>	<u>(23,610)</u>
Income before equity in net income of Cerro	30,411	8,187	34,253	28,029
Equity in net income of Cerro	<u>1,782</u>	<u>10,224</u>	<u>-</u>	<u>-</u>
Net income	32,193	18,411	34,253	28,029
Net income applicable to preferred stock (Note 10)	<u>(6,112)</u>	<u>-</u>	<u>(7,662)</u>	<u>(7,662)</u>
Net income applicable to common stock (Note 10)	<u>\$ 26,081</u>	<u>\$ 18,411</u>	<u>\$ 26,591</u>	<u>\$ 20,367</u>

See accompanying condensed notes.

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (NOTES 1, 2 AND 3)  
(Unaudited)  
Nine Months Ended September 30, 1976  
(In thousands of dollars)

	Preferred stock (Note 9)	Common stock (Note 9)	Other paid-in capital	Retained earnings	TOTAL
Balance at January 1, 1976	\$ -	\$ 1	\$ 12,027	\$ 88,858	\$100,886
Excess of par value of Cerro-Marmon common stock issued to GL over par value of Marmon common stock		4,999	(4,999)		-
Value of preferred stock issuable to Cerro stockholders	89,743				89,743
Contribution by GL (Note 8)			2,588		2,588
Elimination of Marmon deferred income tax applicable to its equity in undistri- buted net income of Cerro			877	(5,827)	877 (5,827)
Preferred dividends paid				(285)	-
Accrual of redemption value of preferred stock (Note 10)	285			32,193	32,193
Net income					
Balance at September 30, 1976	<u>\$ 90,028</u>	<u>\$ 5,000</u>	<u>\$ 10,493</u>	<u>\$114,939</u>	<u>\$220,460</u>

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See accompanying condensed notes.

CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CHANGES  
IN FINANCIAL POSITION (NOTES 1, 2 AND 3)  
(Unaudited)

Nine Months Ended September 30, 1976  
(In thousands of dollars)

Sources of working capital:		
Total provided by operations		\$ 48,682
Merger of Cerro at February 24, 1976 (Note 3) -		
Preferred stock issuable	89,743	
Marmon's basis in 45.33% of Cerro	80,028	
Long-term debt assumed	89,252	
Other - net	12,815	
	<u>271,838</u>	
Less cost assigned to noncurrent assets	<u>107,018</u>	
Total provided by merger of Cerro		164,820
Proceeds from long-term obligations		1,325
Decrease in Chilean notes		<u>12,140</u>
Total working capital provided		226,967
Dispositions of working capital:		
Additions to property, plant and equipment	12,239	
Reduction in long-term obligations (Note 7)	70,561	
Increase in other assets	4,823	
Preferred dividends paid	5,827	
Other	<u>3,641</u>	
Total working capital used		97,091
Increase in working capital		129,876
Working capital at January 1, 1976		<u>62,290</u>
Working capital at September 30, 1976		<u><u>\$ 192,166</u></u>

See accompanying condensed notes.

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## CERRO-MARMON CORPORATION

### CONDENSED NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The accompanying condensed consolidated financial statements, which are for an interim period, do not include all disclosures provided in annual financial statements. Reference is made to the condensed consolidated financial statements and related notes thereto included in Cerro-Marmon's Form 10-Q for the quarter ended March 31, 1976.

#### 1. Organization

Cerro-Marmon Corporation (Cerro-Marmon), incorporated on November 25, 1975, was inactive until February 24, 1976. On that date (1) Cerro-Marmon issued 5 million shares of common stock to GL Corporation (GL) for all of the outstanding common shares of The Marmon Group, Inc. (Michigan) (Marmon), in a transaction accounted for as if it was a pooling of interests, and (2) Cerro-Marmon issued preferred stock to holders of Cerro Corporation (Cerro) common stock, other than Marmon, on a share-for-share basis, and Cerro was merged into Cerro-Marmon in a transaction accounted for as a purchase (Note 3).

#### 2. Basis of the financial statements and consolidation policy

The consolidated financial statements for periods prior to February 25, 1976 consist of the historical financial statements of Marmon and all subsidiaries, including Marmon's 45.33% interest in Cerro which is accounted for on an equity basis.

The consolidated financial statements as of dates and for periods subsequent to February 24, 1976 include the accounts of Cerro-Marmon and all subsidiaries (including the former Cerro businesses and subsidiaries) except the real estate subsidiaries (principally Leadership Housing, Inc.) (Leadership) (see Note 5) and certain immaterial foreign subsidiaries.

The pro forma statements of income consist of (1) the historical statements of Marmon and Cerro for the 1975 periods and the period January 1, 1976 to February 24, 1976, adjusted on a pro forma basis to give effect to the adjustments resulting from the merger of Cerro into Cerro-Marmon, as if the merger had been completed on January 1, 1975 and (2) the historical statements of Cerro-Marmon for the periods subsequent to February 24, 1976.

The accompanying condensed consolidated financial statements include all adjustments which, in the opinion of management, are necessary for a fair presentation of the consolidated financial position, results of operations and changes in financial position.

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### 3. Acquisition of Cerro

Effective August 1, 1974, Marmon acquired a 45.33% equity interest in Cerro, at a total cost of \$67,846,000. On February 24, 1976, Cerro was merged into Cerro-Marmon (Note 1). Pursuant thereto, the former common stockholders of Cerro, other than Marmon, became entitled to receive one share of Cerro-Marmon \$2.25 Cumulative Series A Preferred Stock (Note 9) for each share of Cerro common stock. The preferred shares issuable were valued by the Board of Directors of Cerro-Marmon at \$20.75 per share, based on an estimated fair value of the preferred stock determined when the exchange ratio was approved by the Board of Directors of Cerro.

The above described transactions have been accounted for as a purchase of Cerro by Cerro-Marmon. Accordingly, the net assets of the businesses formerly conducted by Cerro and included in the consolidated balance sheet of Cerro-Marmon are reflected at amounts determined after giving effect to a preliminary allocation of Cerro-Marmon's purchase cost to such net assets. The allocations of purchase cost to Cerro's net assets were made as of August 1, 1974 as to the 45.33% interest in Cerro acquired as of that date and as of February 24, 1976 as to the 54.67% interest in Cerro acquired as of that date. The effect of the purchase cost allocation was to significantly reduce the amounts at which Cerro's historical consolidated net assets are included in the Cerro-Marmon consolidated balance sheet. THE RESULTS OF SUCH PRELIMINARY ALLOCATION ARE SUBJECT TO CHANGE TO REFLECT ADDITIONAL INFORMATION OBTAINED AND REALIZATION OF ANY BENEFITS FROM CERRO'S PRIOR INCOME TAX LOSSES.

The purchase cost allocations had the effect of significantly increasing the net earnings of Cerro-Marmon. This effect resulted principally from (1) reductions in depreciation and amortization expense relating to the reduced carrying value of property, plant and equipment and intangible assets and (2) the elimination of losses from the real estate operations, see Note 5. SUCH AMOUNTS ARE SUBJECT TO RETROACTIVE ADJUSTMENT TO REFLECT THE EFFECTS OF ANY CHANGES MADE TO THE ALLOCATION OF PURCHASE COST AND THE EFFECT OF ANY REALIZATION OF BENEFITS FROM CERRO'S PRIOR INCOME TAX LOSSES.

For purposes of determining Marmon's equity in Cerro's net earnings, losses of real estate subsidiaries were adjusted to reflect the effects of the purchase cost allocation to the investment in Leadership. These adjustments in the nine months ended September 30, 1975 consisted principally of the elimination of direct losses from realty sales, inventory write-downs and write-off of goodwill (no such adjustments were required in the period January 1, 1976 to February 24, 1976). Effective February 25, 1976, all net gains or losses from the real estate subsidiaries' operations and from inter-company transactions with the real estate subsidiaries (including

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income taxes related thereto), for a two-year period (or appropriate shorter period), will be credited or charged to a reserve for losses (Note 5). This change in estimate increased Cerro-Marmon's consolidated net income for the period February 24, 1976, to September 30, 1976, by approximately \$2,300,000.

The treatment followed by Marmon for purposes of determining its equity in Cerro's earnings was deemed appropriate based on information known at the time of adoption. However, the present status of the real estate subsidiaries and the uncertainties relating to their operations, as discussed in Note 5, indicate that the treatment adopted by Cerro-Marmon is more reflective of the present circumstances and will result in consolidated operating results that are more reflective of the effects of the purchase of Cerro at an amount substantially less than Cerro's historical net asset value.

#### 4. Inventories

The last-in, first-out (LIFO) cost of inventories (approximately 23% of inventories included in the accompanying condensed consolidated balance sheet) valued under this method was approximately \$26 million less than the approximate current cost (determined principally on the basis of standard costs) of these inventories. It is not practicable to classify inventories by stage of production.

#### 5. Real estate subsidiaries

Effective April 1, 1976, certain of the assets of Leadership were transferred to The Housing Group, Inc., a newly formed subsidiary of Cerro-Marmon. Cerro-Marmon's investment in these unconsolidated real estate subsidiaries is included in the condensed consolidated balance sheet at Cerro-Marmon's equity in the net assets of such subsidiaries, less a reserve for future losses. Details of such investment at September 30, 1976 follow, in thousands:

Investment - net	\$ 35,452
Less reserve for losses	<u>34,229</u>
Net carrying value	<u>\$ 1,223</u>

Changes in the reserve from February 25, 1976 to September 30, 1976 are as follows, in thousands:

Balance at February 25, 1976	\$ 36,480
Net loss for the period, as reported by the real estate subsidiaries	(5,419)
Other - net	<u>3,168</u>
Balance at September 30, 1976	<u>\$ 34,229</u>

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A condensed combined statement of operations, as reported by the real estate subsidiaries, follows, in thousands:

COMBINED STATEMENT OF OPERATIONS

	Three months ended <u>September 30, 1976</u>	Period February 25, 1976 to <u>September 30, 1976</u>
Sales	\$ 17,488	\$ 29,852
Interest and other revenue	<u>1,274</u> 18,762	<u>3,333</u> 33,185
Costs and expenses:		
Cost of sales	16,756	28,854
Selling and administrative	1,822	4,142
Interest, net of capitalized interest	<u>2,306</u>	<u>5,608</u>
Net loss	<u>\$ 2,122</u>	<u>\$ 5,419</u>

On August 13, 1975, management stated its intention to reduce substantially the business, operations and debt levels of the real estate subsidiaries through an orderly liquidation of inventories designed to minimize losses. It is expected that, after this reduction is completed, the total assets would be less than half of the total assets at December 31, 1974. As a result of the condition of the real estate market existing in the United States generally, and in Florida in particular, an orderly liquidation of inventories designed to preserve corporate assets is likely to take several years. This liquidation may take place while adverse market conditions prevail. To the extent the reduction results in the disposition of inventories other than in the normal course of business and during a period in which adverse market conditions prevail, the estimated net realizable value may be adversely affected by an undeterminable amount.

The real estate subsidiaries have historically utilized their own sales transactions, as well as sales of comparable land and land improvements of others, as one of the primary factors in the determination of estimated net realizable value. Based upon information available in 1975, a determination of net realizable value was made which resulted in provisions for writedown of inventories at December 31, 1975. However, the decline in comparable transactions together with adverse market conditions and the inventory reduction plan mentioned above have created significant uncertainties with respect to the determination of estimated net realizable value. Accordingly, uncertainties are created as to the amount and timing of the

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ultimate realization upon disposition of land and land improvement inventories carried on the books of the real estate subsidiaries (approximately \$63,000,000 at September 30, 1976).

The estimated net realizable value of unimproved property (\$40,095,000 at September 30, 1976) held by the two joint ventures in which Leadership is a participant with the Pritzker Trusts (the beneficiaries of the Pritzker Trusts are members of the Pritzker family, including J. A. Pritzker and R. A. Pritzker, principal officers and directors of Cerro-Marmon; the Pritzker family is also the beneficial owner of GL) is subject to the same uncertainties as described in the preceding paragraph. While Leadership has no investment in these particular ventures, it is contingently liable to lenders with respect to approximately \$18.5 million of notes payable by the joint ventures at September 30, 1976.

Events of Default existed at September 30, 1976 under certain of the covenants in the Loan Agreement of Leadership. It is anticipated that additional Events of Default may occur in 1976 as a result of continuing unprofitable operations, which may be affected by the outcome of litigation involving certain receivables aggregating \$1,565,000, the ultimate collectibility of which cannot presently be determined. If Events of Default occur, the Loan Agreement provides that, upon notification from the principal lenders, the debt covered thereby would become due and payable. The existing Loan Agreement is currently being renegotiated, the outcome of which cannot be determined at this time.

Cerro financially supported the operations of Leadership prior to the merger. In June of 1976 Cerro-Marmon entered into a \$2,000,000 non-revolving secured working capital loan agreement which was fully utilized by Leadership. At September 30, 1976, \$479,000 remained outstanding and was subsequently repaid. No decision has been reached as to how long Cerro-Marmon will continue its support if Leadership's current operating losses continue, the Loan Agreement does not provide adequate support during the orderly liquidation period described above, or if the principal lenders withdraw their support. Cerro-Marmon also has legally binding commitments in connection with surety bonds (approximately \$30 million at September 30, 1976) guaranteeing performance under certain construction contracts. A substantial amount of work has been performed under these contracts, but it is not possible to predict the cost to Cerro-Marmon, if any, under the surety bonds.

Notes payable of the real estate subsidiaries at September 30, 1976 consist of the following, in thousands:

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Obligations to banks*	\$ 43,713
Real estate mortgages, 7% to prime plus 5.5%, due to 2011	36,698
Unsecured notes, 6-8%, due to 1982	<u>1,989</u>
	<u>\$ 82,400</u>

\*Borrowed by Leadership pursuant to an Amended and Restated Loan Agreement ("Agreement") dated April 1, 1975 and evidenced by a \$44,500,000 note due April 1, 1977, subject to acceleration as provided in the Agreement. The note bears interest at the rate of 1- $\frac{1}{4}$ % above the Bank's Alternate Base Rate. Two per cent of such interest is payable monthly in cash and the difference between the 2% and the 1- $\frac{1}{4}$ % over the Bank's Alternate Base Rate is accrued until the total accrued interest equals \$5,000,000, after which Leadership shall pay to the Bank in cash the full 1- $\frac{1}{4}$ % above the Bank's Alternate Base Rate. The balance of the accrued interest shall be paid at maturity.

The Agreement provides, among other things, for maintenance of minimum tangible net worth, limitations on the purchase of real estate, the sale of certain assets and investments in new properties or joint ventures. In addition, Leadership is required to maintain certain collateral coverage ratios and meet specified cash flow objectives (based on quarterly projections) which, if not met, could be deemed Events of Default by the Bank.

Generally, loans under the Agreement are secured by the assignment of notes, mortgages and deeds of trust; a pledge of the capital stock of one of Leadership's wholly-owned subsidiaries; the granting to the Bank of a first mortgage on most of Leadership's unencumbered real estate; an agreement to assign notes and mortgages acquired after the closing date; an agreement to grant first mortgages on real estate acquired after the closing date; the assignment of Leadership's beneficial interest in two land trusts; an assignment of its interest in a joint venture and its right to cash distributions from its other two joint ventures; the assignment of Excess Cash Proceeds, as defined, if any, from any future sale of Tamarac Utilities, Inc. by Cerro-Marmon to third parties; and the assignment to the Bank of all of Leadership's rights in a Tax Allocation Agreement dated July 31, 1972. In addition, Leadership has assigned a purchase money note of Cerro-Marmon (\$3,375,000 at September 30, 1976) with all principal prepayments thereon to be applied to the Bank's note. Certain amounts due to Cerro-Marmon by Leadership are subordinated to the Bank's claims.

#### 6. Income taxes

Cerro-Marmon is to be included in the consolidated federal

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income tax return of GL. Prior to February 25, 1976, Marmon was included in the GL consolidated federal income tax return. Pursuant to a formal tax sharing agreement with GL, federal income taxes of Cerro-Marmon will be determined, in general, as if the former Cerro affiliated tax group and the Marmon affiliated tax group each filed separate consolidated tax returns. Prior to February 25, 1976, federal income taxes of Marmon were determined, in general, as if Marmon and its domestic subsidiaries filed a separate consolidated tax return. Federal income taxes so determined have been paid periodically to GL by Marmon and will be paid periodically to GL by Cerro-Marmon except that (1) the former Cerro affiliated tax group shall not be required to make any tax sharing payments during any taxable period in which Cerro-Marmon has not currently paid all prescribed dividends or made sinking fund payments on its Series A preferred stock and (2) during all other taxable periods the members of the former Cerro affiliated group shall retain, without restriction, 50% of any tax sharing payments that would be due to any member of the GL affiliated group.

As a member of the GL consolidated federal income tax group, Cerro-Marmon (and Marmon prior to February 25, 1976) is contingently liable for the federal income taxes of the other members of the group. GL has agreed to indemnify Cerro-Marmon (and Marmon) for any federal income taxes attributable to other members of the group.

Federal income taxes accrued but not yet paid to GL or payments to GL in excess of amounts accrued are included as income taxes payable or as refundable income taxes in the consolidated balance sheet. Interest at 115% of the bank's prime rate is paid or received on differences between payments made and payments due.

On January 22, 1974, the Internal Revenue Service advised Cerro by a private ruling letter than it considered the Cerro de Pasco expropriation loss to have resulted from a compulsory or involuntary conversion of the stock of Cerro de Pasco and that the loss qualified as an ordinary loss which could be carried over and applied against the Cerro affiliated group income for as long as ten years to the extent not consumed during the taxable year in which it arose.

By letter dated May 12, 1976, the Internal Revenue Service advised Cerro-Marmon that the January 22, 1974 ruling letter was being retroactively revoked with respect to the conclusion that the loss was an involuntary conversion of the stock of Cerro de Pasco and held that the transaction will be treated as an expropriation of assets.

Accordingly, Cerro-Marmon may be required to establish

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the tax basis of the Cerro de Pasco assets which were expropriated. The Company believes such adjusted basis can be established. However, the proof of basis of assets (as compared to basis in stock) may be more difficult. The retroactive reversal of the January 22, 1974 ruling letter could also affect the technical elements for substantiating the continued availability of the net operating loss carryover derived from the expropriation loss, which availability may be determined under Section 382(a) of the Code. Cerro-Marmon believes and has been advised by its outside tax counsel that the net operating loss carryover from Cerro should not be subject to disallowance under Section 382(a).

At September 30, 1976, Cerro-Marmon had losses (losses of Cerro relating to the expropriation of Cerro de Pasco) which could result in reductions up to approximately \$26,000,000 in future federal income taxes. Realization of the benefits of such losses will not directly effect the reported net income of Cerro-Marmon as any benefits realized will be credited to balance sheet accounts.

Income tax expense (benefit) consists of the following, in thousands:

	Three months Ended September 30, 1976	Nine months Ended September 30, 1976
United States:		
Current	\$ 3,560	\$ 11,170
Deferred	(5)	(38)
Provision in lieu of income taxes	5,751	12,456
Foreign:		
Current	11	76
Deferred	46	202
State	<u>1,742</u>	<u>4,518</u>
	<u>\$ 11,105</u>	<u>\$ 28,384</u>

7. Long-term debt and lease-purchase obligations

Details of long-term debt at September 30, 1976 follow, in thousands:

Notes due to institutions, 6½-6.125% (discounted to an effective rate of 9.5%), due to 1987	\$ 25,982
Notes due to corporations, 9.5%, due 1977-1987	35,000
Notes due to individuals, 5% (discounted to an effective rate of 9%), due to 1980	5,821

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Subordinated debentures, 7%, due to 1990	3,842
Subordinated notes, 12%, due to 1984	2,656
Other	10,444
	<u>\$ 83,745</u>

Notes due to banks of \$26,000,000 at September 30, 1976 were repaid on October 25, 1976. Accordingly, this amount has been reflected as a current liability at September 30, 1976.

The various debt agreements impose certain restrictions on Cerro-Marmon and certain subsidiaries (including Marmon), including restrictions on the payment of cash dividends and the repurchase of capital stock. Pursuant to provisions of the most restrictive of the agreements, Cerro-Marmon had approximately \$7,700,000 available for the payment of cash dividends and the repurchase of capital stock at September 30, 1976, after giving retroactive effect to the loan prepayment referred to in the preceding paragraph.

Details of lease-purchase obligations at September 30, 1976 follow, in thousands:

3.5 % to 6.8 %, due to 1988	\$ 4,246
5.25% to 9.5 %, due to 1993	6,700
5% to 7.5 %, due to 1994	5,115
6% to 8.25%, due to 1990	1,250
	<u>\$ 17,311</u>

Scheduled maturities of the long-term debt and lease-purchase obligations in the five calendar years 1977-1981 are \$12,696,000 in 1977, \$12,838,000 in 1978, \$12,591,000 in 1979, \$9,174,000 in 1980 and \$9,198,000 in 1981.

Certain of the long-term debt and all of the lease-purchase obligations are secured by certain property, plant and equipment.

#### 8. Litigation

Cerro-Marmon is subject to the possible effects of various litigation commenced against several defendants, including GL, Cerro and Marmon, in 1975 and 1976, relating principally to the purchase of Cerro stock by Marmon in 1974 and the merger of Cerro into Cerro-Marmon, all of which actions are pending in the United States District Court for the Southern District of New York. These actions allege violations of the anti-fraud provisions of the federal securities laws and common law and derivative claims, and various wrongdoings on the part of the various defendants and request various reliefs.

In April 1976, the parties involved in several of the actions agreed to two stipulations of settlement, subject

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to court approval, whereby (1) GL will pay for the benefit of the defined plaintiff classes (former Cerro common stockholders) up to \$2,550,000 for settlement of the actions, plaintiff's counsels' fees and expenses and other costs, and (2) certain of the defendants, not including Marmon, will pay to Cerro-Marmon \$750,000 (including amounts to be paid for plaintiff's counsels' fees and expenses) for settlement of the derivative claims.

The cost to GL of the proposed payments in (1) above has been reflected in the accompanying financial statements as a contribution to the capital of Cerro-Marmon and as an additional cost of the Cerro common stock acquired. The amount to be received by Cerro-Marmon for the settlement of the derivative claims will be reflected in the Cerro-Marmon financial statements upon receipt of the funds with usage limited to payment of regular dividends to the preferred stockholders.

A hearing was held in May 1976 for approval by the court of the settlement terms and action by the court is presently pending.

The above described proposed settlement does not include a purported class action relating to the merger of Cerro into Cerro-Marmon filed in February 1976 in New York State Court against several defendants including Marmon, Cerro and Cerro-Marmon. This action is based on several alleged causes of action, and asks that there be an injunction against a merger between Cerro and Cerro-Marmon that will divest the public stockholders from a residual equity position, or on terms other than as are presented to the court and determined by it to be fair and for costs including attorneys' fees to the plaintiffs. The complaint alleges (1) no corporate benefit for Cerro in which the public stockholders will share, (2) that the merger will "freeze out" the plaintiff class from Cerro's "residual equity", (3) that the preference stock will not share in the residual equity or possible future growth or improvements in Cerro's financial position, and (4) that certain defendants (some of whom are officers and/or directors of Marmon and Cerro-Marmon) breached their fiduciary duties owed to the public stockholders. Other causes of action allege breaches of fiduciary duties by certain defendants (some of which are officers and/or directors of Cerro-Marmon and Marmon) relating to (1) a \$25,000,000 capital contribution to Marmon by Cerro-Marmon, (2) the adequacy of the payment for the Cerro common shares which is being received by the plaintiff class, (3) preparation of the documentation with respect to the merger and (4) misappropriation of the benefits of the merger to be shared by the plaintiff class. In February 1976 the injunction to stay the merger was denied; this denial has been appealed. An action, substantially similar in all respects to the February 1976 action discussed above, except that it also alleges violation of the anti-fraud provisions

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of federal securities law, was subsequently filed in Federal Court in New York.

In the opinion of counsel, the claims in these class actions will not be sustained.

Other legal actions against Cerro-Marmon or its subsidiaries are not expected to materially effect Cerro-Marmon's consolidated financial statements.

#### 9. Capital stock

The authorized capital stock of Cerro-Marmon consists of 10,000,000 shares of \$1 par value preferred stock and 10,000,000 shares of \$1 par value common stock.

##### Preferred -

At September 30, 1976, 4,324,970 shares of preferred stock were issuable which includes such shares, not as yet determined, applicable to former Cerro stockholders who will be paid in cash pursuant to their perfected dissenters' rights. These shares, designated "\$2.25 Cumulative Series A Preferred Stock", are entitled among other things, to dividends at the annual rate of \$2.25 per share on a cumulative basis, a liquidation preference of \$22 per share plus accrued dividends, and are voting (one vote per share). All or part of the Series A stock may be redeemed by Cerro-Marmon on or after April 1, 1981 at \$22 per share plus accrued dividends. Commencing in 1982, 6-2/3% of the Series A shares originally issued are to be redeemed annually until all such shares are redeemed or acquired by Cerro-Marmon. Pursuant to terms of the proposed settlement of certain litigation (Note 8), the annual dividend rate on the Series A stock will be increased to \$2.35 per share beginning 1981.

##### Common -

At September 30, 1976, 5,000,000 shares of common stock were issued and outstanding (entitled to four votes per share). Pursuant to terms of the proposed settlement of certain litigation (Note 8), no payments could be made with respect to the common stock until consolidated stockholders' equity is \$10,000,000 greater than such equity on February 24, 1976. As a result of the above, approximately \$12,000,000 is available at September 30, 1976 for payments with respect to the common stock.

#### 10. Net income applicable to preferred stock

The amount shown in the consolidated statement of income for the nine months ended September 30, 1976 consists of \$5,827,000 of dividends applicable to the Series A preferred stock and

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\$285,000 for the accrual of the excess of the redemption value over the value assigned to the Series A preferred stock issuable, both for the period February 25, 1976 to September 30, 1976. For the quarter ended September 30, 1976 the comparable figures are \$2,432,000 for dividends and \$122,000 for the accrual of the excess of the redemption value over the value assigned to the preferred stock.

11. Sale of Trucking Subsidiary

On September 27, 1976, Cerro Motor Express, a wholly owned subsidiary of Cerro-Marmon Corporation, announced it had reached an agreement for the sale of its trucking subsidiary, ICX Industries, Inc. to ICX Corporation, a newly created corporation formed by certain employees of the trucking concern. Closing of the transaction, which is subject to ICX Corporation obtaining a favorable tax ruling, satisfactory financing and other approvals, is expected to occur in the first quarter of 1977. It is expected that Cerro-Marmon will acquire a minority interest in ICX Corporation. Terms of the transaction, however, have not been finalized. The transaction, if completed, will result in a significant gain to Cerro-Marmon. See Management's Discussion and Analysis of Earnings herein with respect to the trucking operation.

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# MANAGEMENT'S DISCUSSION AND ANALYSIS OF EARNINGS

The comparability of the accompanying historical condensed consolidated statements of income is significantly affected by the merger of Cerro Corporation into Cerro-Marmon Corporation on February 24, 1976 as described in the notes to the condensed financial statements.

Therefore, the following comments relate to a comparison of the results of operations of Cerro-Marmon on a pro forma basis for all periods except for the quarters ended June 30 and September 30, 1976.

Details of net sales and income before income taxes are presented below, in thousands of dollars:

	1976			1975		
	Quarter Ended		Year to date	Quarter Ended		Year to date
	6-30	9-30		6-30	9-30	
<u>Net Sales</u>						
Manufacturing	\$203,887	\$201,251	\$663,986	\$144,493	\$157,669	\$508,614
Mining	21,681	23,684	60,010	18,329	19,036	55,617
Trucking	21,202	21,593	63,302	17,340	19,824	54,060
Total	<u>\$246,770</u>	<u>\$246,528</u>	<u>\$787,298</u>	<u>\$180,162</u>	<u>\$196,529</u>	<u>\$618,291</u>
<u>Income before income taxes</u>						
Manufacturing	\$ 19,629	\$ 19,648	\$ 58,398	\$ 11,655	\$ 17,021	\$ 43,283
Mining	2,855	4,953	8,907	4,219	2,375	13,586
Trucking	1,617	1,596	4,209	1,513	1,451	3,758
Corporate administrative, int. and other exp. less misc. revenues	<u>(1,471)</u>	<u>(2,426)</u>	<u>(5,455)</u>	<u>(4,119)</u>	<u>(2,743)</u>	<u>(8,988)</u>
<u>Income before income taxes</u>	<u>\$ 22,630</u>	<u>\$ 23,771</u>	<u>\$ 66,059</u>	<u>\$ 13,268</u>	<u>\$ 18,104</u>	<u>\$ 51,639</u>

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### Manufacturing

Net sales of \$201,251,000 for the third quarter of 1976 were down by \$2,636,000 from the second quarter of 1976 and up approximately 28% or \$43,582,000 from the third quarter of 1975. For the nine months ended September 30, 1976, net sales were up about 31% over the comparable prior year period.

Pre-tax income in the third quarter of 1976 was \$19,648,000, a slight increase over the 1976 second quarter but an increase of \$2,627,000 over the 1975 third quarter. Year-to-date 1976 income of \$58,398,000 was up \$15,115,000 from the year-to-date 1975 period.

Year-to-date and third quarter 1976 sales and earnings as compared to the comparable 1975 periods reflect the improvements resulting from increased copper prices early in 1976 as well as increased sales and profits in the tubular steel, automotive and building product lines. Demand in general was up in all major product lines compared to the poorer economic conditions and strike depressed levels of 1975.

Third quarter 1976 sales and income compared to the second quarter amounts reflect the relative stability in prices, costs and sales levels.

### Mining

Third quarter sales of \$23,684,000 were up \$2,003,000 from the second quarter and \$4,648,000 from 1975's third quarter (after reclassification of 1975 freight charges which were previously included in sales and are now classified as a reduction of costs). Although selling prices in the third quarter of 1976 were lower than in both prior periods, sales revenues increased because of improved spot market demand, due to the coal strike, and catch-up shipments under a long-term contract.

Pre-tax earnings in the third quarter were \$2,098,000 higher than the second quarter and \$2,578,000 higher than the third quarter of 1975. This improvement is due principally to increased tonnages shipped.

Sales for the first nine months of 1976 and 1975 were \$60,010,000 and \$55,617,000. Pre-tax income was \$8,907,000 and \$13,586,000 for the first nine months of 1976 and 1975. The sales increase results from lower selling prices and margins on higher spot market tonnage shipments.

### Trucking

Operating revenues of \$21,593,000 for the third quarter

LS 000869

of 1976 were about 23% higher than the second quarter of 1976 and about 9% higher than the third quarter of 1975. Rate increases in the fall of 1975 and April 1976 are the principal causes of this improvement.

Pre-tax income of \$1,596,000 for the third quarter of 1976 is up from the \$1,451,000 for the third quarter of 1975. The 1976 increase reflects the effect of rate increases.

Revenues of \$63,302,000 for the first nine months of 1976 compares to \$54,060,000 in 1975. Rate increases again are the principal causes of this increase. Pre-tax income of \$4,209,000 for the first nine months of 1976 compares to \$3,758,000 in 1975. This increase reflects the effects of the rate increases.

#### Real estate subsidiaries

For reasons discussed in Notes 3 and 5 to the consolidated financial statements, no amounts relating to the real estate operations are included in the accompanying consolidated statements of income. Sales were \$17,488,000 for the third quarter of 1976 compared with \$10,487,000 for the second quarter of 1976 and \$7,157,000 for the third quarter of 1975.

Although market conditions have improved on the west coast, principally in California, total real estate operations continue to operate at a loss based on the historical financial statements of the real estate subsidiaries, which do not reflect any purchase cost allocation adjustments resulting from the purchase of Cerro by Cerro-Marmon. Such loss before income taxes was approximately \$2,100,000 in the third quarter of 1976 compared with a loss of approximately \$2,400,000 in the second quarter of 1976 and \$8,500,000 in the third quarter of 1975. Losses are expected for the balance of the year.

#### Corporate administrative, interest and other expense, less miscellaneous revenues

Costs for the third quarter of 1976 of \$2,426,000 compares to \$1,471,000 in the second quarter of 1976 and \$2,743,000 in the third quarter of 1975. The third quarter of 1976 includes a loss of approximately \$800,000 relating to the operations and sale of the fluorspar mining properties in Kentucky and Tennessee which were sold on July 31, 1976. The principal causes for the reduction from the 1975 level are the reduction of home office costs and lower interest expense, which is a result of a reduction in short and long-term borrowings, partially offset by a reduction in investment income and the sale of the fluorspar operations referred to above.

Nine months net costs were \$5,455,000 in 1976 compares to \$8,988,000 in 1975. This reduction resulted principally for the reasons noted above.

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OTHER FINANCIAL INFORMATION

No reports on Form 8-K were required to be filed for the three months ended September 30, 1976 with respect to any material unusual charges or credits to income or a change in independent accountants.

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Sales of unregistered securities (debt or equity)

There were no sales of unregistered securities as defined in Section 2(1) of the Securities Act of 1933 during the three months ended September 30, 1976.

LS 000871




SIGNATURES

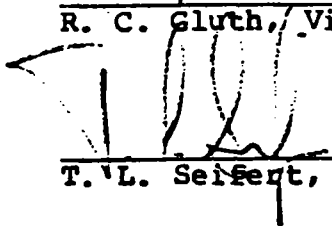
Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CERRO-MARION CORPORATION  
(Registrant)

DATE: November 5, 1976

  
R. C. Gluth, Vice-President

DATE: November 5, 1976

  
T. L. Seifert, Secretary

LS 000872

*File Copy*

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended March 31, 1977 Commission File Number 1-7285

Cerro-Marmon Corporation

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

52-104-5483

(I.R.S. Employer  
Identification No.)

39 South LaSalle Street, Chicago, Illinois  
(Address of principal executive offices)

60603  
(Zip code)

Registrant's telephone number, including area code (312) 372-9500

Not applicable

Former name, former address and former fiscal year, if changed  
since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No     

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of the period covered by this report.

5,000,000 shares of Common Stock were issued and outstanding  
at March 31, 1977.

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CERRO-MARMON CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEET  
(In thousands of dollars)  
(Unaudited)

ASSETS

	March 31, 1977	1976 <u>Restated</u> (Notes 1, 2 and 9)
Current assets:		
Cash and cash equivalents	\$ 11,303	\$ 16,083
Marketable securities	7,079	37,685
Receivables - net	156,801	110,255
Inventories (Note 3)	260,843	154,048
Other current assets	<u>8,404</u>	<u>9,712</u>
Total current assets	444,430	327,783
Investments in and advances to nonconsolidated subsidiaries:		
Trucking (Note 4)	17,417	14,842
Realty (Note 5)	21,877	16,155
Notes due from Chile	2,846	12,572
Property, plant and equipment - net	103,434	97,308
Other investments and assets	<u>18,634</u>	<u>17,100</u>
	<u>\$608,638</u>	<u>\$485,760</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Notes payable to banks	\$ 67,783	\$ 11,728
Long-term obligations due within one year	12,720	12,539
Accounts payable	73,014	51,000
Income taxes (Note 6)	28,173	18,512
Accrued liabilities	<u>42,682</u>	<u>33,796</u>
Total current liabilities	224,372	127,575
Long-term obligations	99,286	140,405
Deferred credit from acquisition (Note 2)	17,994	4,845
Other non-current amounts	16,962	12,546
Contingencies (Notes 2 and 8)		
Shareholders' equity:		
Preferred stock, liquidation preference and redemption value of \$93,699	89,509	88,462
Common stock	5,000	5,000
Other paid-in capital	26,489	10,241
Retained earnings	<u>129,026</u>	<u>96,686</u>
Total shareholders' equity	<u>250,024</u>	<u>200,389</u>
	<u>\$608,638</u>	<u>\$485,760</u>

See Condensed Notes to Condensed Consolidated Financial Statements.

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF INCOME

(In thousands of dollars)  
(Unaudited)

	<u>Three Months Ended</u> <u>March 31,</u>	
	<u>1977</u>	<u>1976</u>
		<u>Restated</u>
	(Notes 1, 2 and 9)	
Revenues:		
Net sales	\$308,976	\$193,405
Miscellaneous - net (Notes 5 and 7)	<u>1,078</u>	<u>1,257</u>
	<u>310,054</u>	<u>194,662</u>
Costs and expenses:		
Cost of sales	265,977	170,914
Selling and administrative	19,819	9,896
Interest	<u>3,144</u>	<u>2,137</u>
	<u>288,940</u>	<u>182,947</u>
Income before amounts shown below	21,114	11,715
Income taxes (Notes 5 and 6)	<u>12,555</u>	<u>4,992</u>
Income before equity in net income of Cerro Corporation and discontinued business	8,559	6,723
Equity in net income from continuing operations of Cerro Corporation (Note 1)	<u>8,559</u>	<u>1,436</u>
		<u>8,159</u>
Income of discontinued business less income taxes (Note 4)	<u>516</u>	<u>719</u>
Net income	9,075	8,878
Net income applicable to preferred stock	<u>(2,657)</u>	<u>(1,050)</u>
Net income applicable to common stock	<u>\$ 6,418</u>	<u>\$ 7,828</u>

See Condensed Notes to Condensed Consolidated Financial Statements.

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (NOTES 1 AND 2)

Three Months Ended March 31, 1977

(In thousands of dollars)  
(Unaudited)

	Preferred Stock	Common Stock	Other Paid-in Capital	Retained Earnings	Total
Balance at December 31, 1976	\$89,248	\$5,000	\$10,241	\$122,608	\$227,097
Net income				9,075	9,075
Preferred dividends				(2,396)	(2,396)
Contribution by GL (Note 1)			16,248		16,248
Accrual of redemption value of preferred stock	261			(261)	
Balance at March 31, 1977	\$89,509	\$5,000	\$26,489	\$129,026	\$250,024

See Condensed Notes to Condensed Consolidated Financial Statements.

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CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CHANGES  
IN FINANCIAL POSITION (NOTES 1, 2 and 9)

Three Months Ended March 31, 1977  
(In thousands of dollars)  
(Unaudited)

Sources of working capital:

Total provided by continuing operations	\$19,187	
Total provided by discontinued operations	<u>163</u>	
Total provided by operations		\$ 19,350

Acquisition of Hammond -

Capital contribution by GL less amount assigned to net non-current assets of \$2,997	13,251	
Cost of net assets acquired less working capital received of \$18,321	<u>310</u>	
Total resulting from acquisition of Hammond		13,561

Proceeds from long-term obligations		<u>3,159</u>
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Total working capital provided		36,070
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Dispositions of working capital:

Additions to property, plant and equipment - net	3,890	
Reduction in long-term obligations	2,306	
Preferred dividends paid	2,396	
Other - net	<u>2,414</u>	

Total working capital used		<u>11,006</u>
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Increase in working capital		25,064
Working capital at December 31, 1976		<u>194,994</u>

Working capital at March 31, 1977		<u>\$220,058</u>
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See Condensed Notes to Condensed Consolidated Financial Statements.

LS 000877

CERRO-MARMON CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CHANGES  
IN FINANCIAL POSITION (RESTATED) (Notes 1, 2 and 9)

Three Months Ended March 31, 1976  
(In thousands of dollars)  
(Unaudited)

Sources of working capital:

Total provided by continuing operations	\$ 9,847	
Total provided by discontinued operations	<u>231</u>	
Total provided by operations		\$ 10,078

Merger of Cerro at February 24, 1976 -

Preferred stock issued and issuable	88,375	
Marmon's basis in 45.33% of Cerro	80,028	
Long-term obligations assumed	84,104	
Other - net	<u>18,248</u>	
	270,755	
Less cost assigned to non-current assets	<u>108,420</u>	

Total provided by merger of Cerro		162,335
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Proceeds from long-term obligations		1,250
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Decrease in Chilean notes		<u>2,515</u>
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Total working capital provided		176,178
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Dispositions of working capital:

Additions to property, plant and equipment - net	3,530	
Reduction in long-term obligations	26,349	
Increase in other investments and assets	5,930	
Advances to real estate subsidiary	1,211	
Other - net	<u>1,240</u>	

Total working capital used		<u>38,260</u>
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Increase in working capital		137,918
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Working capital at December 31, 1975		<u>62,290</u>
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Working capital at March 31, 1976		<u>\$200,208</u>
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See Condensed Notes to Condensed Consolidated Financial Statements.

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CERRO-MARMON CORPORATION

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1977 and 1976

(Tabular amounts are in thousands of dollars)

(Unaudited)

The accompanying condensed consolidated financial statements, which are for an interim period, do not include all disclosures provided in annual financial statements. Reference is made to the consolidated financial statements and related notes thereto included in the annual report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 1976.

The accompanying condensed consolidated financial statements include all adjustments, consisting only of normal recurring accruals except for a charge to income relating to the termination of long-term employment and other related contracts (Note 7) in the three months ended March 31, 1977, which, in the opinion of management, are necessary for a fair presentation of the condensed consolidated financial position, results of operations and changes in financial position.

1. Organization and Basis of Financial Statements

Cerro-Marmon Corporation (Cerro-Marmon) was inactive until February 24, 1976. On that date Cerro-Marmon acquired from its parent, GL Corporation (GL), (1) all of the outstanding capital stock of The Marmon Group, Inc. (Michigan) (Marmon), including Marmon's 45.33% equity interest in Cerro Corporation (Cerro) acquired in 1974, in a transaction accounted for as if it was a pooling of interest and (2) the remaining 54.67% equity interest in Cerro in a transaction accounted for as a purchase. As a result of these transactions, GL owns 100% of the common stock of Cerro-Marmon, which represents approximately 82% of the total voting interest in Cerro-Marmon. Accordingly, the consolidated financial statements of Cerro-Marmon prior to February 25, 1976 consist of the consolidated financial statements of Marmon, Cerro-Marmon's accounting predecessor company, and all subsidiaries, including Marmon's 45.33% interest in Cerro accounted for on an equity basis. Commencing February 25, 1976 the consolidated financial statements consist of the financial statements of Cerro-Marmon and all significant subsidiaries except the real estate subsidiaries and the trucking subsidiary which is to be sold (Note 4).

The effect of the purchase cost allocations was to significantly reduce the amounts at which Cerro's net assets are included in the Cerro-Marmon consolidated balance sheet from amounts previously reflected in Cerro's historical consolidated balance sheet. Reductions were made principally to investments (including the investment in the real estate subsidiaries), property, plant and equipment, intangible assets and the asset included in the Cerro balance sheet for future income tax benefit. This allocation and the effects thereof on results of operations are subject to retroactive revision to reflect the resolution of certain specific matters discussed in Note 2.

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The purchase cost allocations had the effect of significantly increasing the amount reflected by Marmon as its equity in the net income of Cerro prior to February 25, 1976 and the net income of Cerro-Marmon subsequent thereto. This effect results principally from (1) reductions in depreciation, depletion and amortization of property, plant and equipment and intangible assets, (2) larger gains or lesser losses from dispositions of assets and (3) elimination of net losses from the real estate operations for periods through December 31, 1976, as discussed in the following paragraph.

No amounts have been included in consolidated results of operations applicable to the nonconsolidated real estate subsidiaries for the three months ended March 31, 1976. The loss incurred by these subsidiaries was charged to a reserve established in connection with the allocation of purchase cost to Cerro's net assets because significant uncertainties precluded such allocation to these subsidiaries at the dates of purchase. As discussed more fully in Note 5, various of the uncertainties were substantially resolved as of December 31, 1976 and a purchase cost allocation was made; therefore, the results of operations of the nonconsolidated real estate subsidiaries are reflected in consolidated net income commencing January 1, 1977 on the equity method.

Had the merger of Cerro into Cerro-Marmon been consummated on January 1, 1976, pro forma revenue and net income for the three months ended March 31, 1976 would have been as follows:

Revenues	<u>\$278,217</u>
Income from continuing operations	\$ 10,695
Income from discontinued business	<u>776</u>
Net income	<u>\$ 11,471</u>

The above pro forma amounts consist of the historical amounts applicable to Marmon and Cerro for the period January 1, 1976 to February 24, 1976, adjusted on a pro forma basis to give effect to the adjustments resulting from the merger of Cerro into Cerro-Marmon, and the reported amounts applicable to Cerro-Marmon for the period subsequent to the merger date, both adjusted to reflect the discontinuance of trucking operations. As noted above, no amounts are included for the real estate subsidiaries.

On January 26, 1977 Cerro-Marmon (1) received 48% of the outstanding common stock of Hammond Corporation (Hammond) as a capital contribution from GL and (2) acquired the remaining equity interest in Hammond for cash of approximately \$18,000,000. The acquisition of Hammond has been accounted for as a purchase and the results of operations of Hammond have been included in the condensed consolidated financial statements commencing January 27, 1977. Had the acquisition of Hammond taken place on January 1, 1976, Cerro-Marmon's consolidated revenues and net income for the three months ended March 31, 1977 and 1976, on a pro forma basis and after giving effect to a preliminary allocation of Cerro-Marmon's accounting basis in Hammond to Hammond's net assets, would increase as follows:

LS 000880

	March 31,	
	<u>1977</u>	<u>1976</u>
Revenues	\$10,933	\$32,922
Net income	551	526

## 2. Uncertainties

Significant uncertainties, relating to the former Cerro operations, existed at February 24, 1976. Such uncertainties related principally to the real estate operations (Leadership). Various of the uncertainties have been substantially resolved, with the major remaining uncertainty relating to the ultimate liability that may result from a guarantee by Leadership of the debt of a joint venture in which Leadership participates (Note 5). Such resolution had no material effect on the consolidated financial statements of Cerro-Marmon and the resolution of the remaining uncertainties will have no material effect on such financial statements.

Income tax matters, including matters relating to Cerro's prior year federal income tax position, are discussed in Note 6. On the basis of presently known information, management of Cerro-Marmon does not anticipate any significant change in the prior year federal income tax position of Cerro from that reflected in Cerro's income tax returns other than as previously provided. Further, Cerro-Marmon's management anticipates that the amount of future income tax benefit available from Cerro's prior year losses will be ultimately realized. However, because of the complexities of the matters and because no member of Cerro-Marmon's management was a part of Cerro's management prior to 1975, Cerro-Marmon will continue to include all income tax benefits realized from prior year losses of Cerro in the "Deferred credit from acquisition" in the Cerro-Marmon consolidated balance sheet (rather than being partially applied to reduce the purchase cost allocated to Cerro's former property, plant and equipment) and to reflect no amortization of the deferred credit in income until the matters referred to above, including the matter relating to Leadership, are resolved. The effect thereof on the accompanying condensed consolidated financial statements was not material. Upon resolution, the purchase cost allocated to Cerro's net assets will be retroactively revised to reflect any adjustments resulting from (1) the realization of income tax benefits from prior year losses of Cerro and (2) the outcome of the matters discussed above relating to Leadership and the prior year federal income tax position of Cerro. Further, provisions for depreciation and depletion will be retroactively adjusted to reflect the effects of any revision of purchase cost allocated to property, plant and equipment and amortization of any deferred credit will be retroactively included in income. Any retroactive adjustments required will not have a material effect on consolidated working capital and shareholders' equity at March 31, 1977 and 1976.

## 3. Inventories

	March 31,	
	<u>1977</u>	<u>1976</u>
Metal trading inventories	\$ 79,511	\$ 26,180
Coal inventories and supplies	9,584	12,224
Manufacturing inventories and supplies	<u>171,748</u>	<u>115,644</u>
	<u>\$260,843</u>	<u>\$154,048</u>

LS 000881

Inventories valued under the LIFO method were approximately \$31,000,000 less than the current costs of such inventories at March 31, 1977 (\$26,000,000 at March 31, 1976). The classification of manufacturing inventories by stage of production is not available from the accounting records.

#### 4. Investment in Trucking Subsidiary

Cerro-Marmon intends to sell its majority-owned trucking subsidiary, ICX Industries, Inc., to ICX Corporation, a corporation formed by certain employees of the trucking subsidiary, for approximately \$22,600,000 in cash, a subordinated note of approximately \$5,500,000 (subject to changes in the net asset value of the subsidiary to date of sale), which bears interest at prime plus 4½% per annum, and a 19.8% equity interest in ICX Corporation. Such sale is expected to be completed in June 1977. Accordingly, the trucking subsidiary is reflected in the financial statements as a discontinued business. The gain to be realized on the sale, before income taxes, is estimated at approximately \$5 million based on the cash proceeds to be received. The gain represented by the notes and stock will be reflected as amounts are realized in cash.

Net assets of the discontinued trucking business, after giving effect to Cerro-Marmon's purchase cost allocations, at March 31, 1977 follow:

Current assets	\$ 9,296
Current liabilities	<u>8,695</u>
Net current assets	601
Property and equipment - net	13,548
Operating rights and other assets	6,489
Non-current obligations	<u>(3,221)</u>
Net assets	<u>\$ 17,417</u>

The amounts shown in the consolidated statement of income as income of discontinued business for the period January 1, 1976 to February 24, 1976 consist of Marmon's 45.33% equity in the net income of Cerro's trucking subsidiary, less Marmon's income taxes relating thereto, and for periods subsequent thereto consist of the adjusted income of the trucking subsidiary, less related income taxes.

For the three month periods ended March 31, 1977 and 1976 ICX Industries, Inc. reported revenues of \$20,700,000 and \$20,570,000, respectively.

#### 5. Investment in Real Estate Subsidiaries

No amounts have been included in the consolidated results of operations applicable to real estate subsidiaries for the three months ended March 31, 1976 as the loss incurred by these subsidiaries was charged to a reserve established for such purpose by the initial purchase cost allocations. This reserve was established because various uncertainties relating to the real estate operations precluded an allocation of purchase cost to the real estate assets at the dates of acquisition of Cerro. Certain of these uncertainties were substantially resolved by the modification of certain agreements and restructuring of debt obligations concluded in February 1977, the reductions in inventories and the restructuring of the activities

LS 000882

of the real estate subsidiaries, and the general improvement in the market in the various areas in which the real estate operations are conducted. The most significant remaining uncertainty relates to the guarantee of debt of a joint venture in which Leadership is a participant (see the third paragraph of this note). The above-described events permitted a quasi-reorganization of Leadership as of December 31, 1976 at which date its assets were revalued to reflect their fair market values. These revised asset values were used as the basis for finalizing the purchase cost allocation to the real estate assets and to Cerro-Marmon's investment in the real estate subsidiaries. Commencing January 1, 1977, Cerro-Marmon has reflected its equity in the net loss of the real estate subsidiaries in the condensed consolidated financial statements. A condensed combined statement of operations, exclusive of the effects of the quasi-reorganization and debt restructuring which were reflected as of December 31, 1976 and after giving effect to adjustments relating to the purchase cost allocation, for the three months ended March 31, 1977 follows:

Sales	\$4,973
Interest and other revenue	553
Realized gross profit on installment receivables	3,467
Costs and expenses:	
Cost of sales	(4,503)
Selling and administrative	( 969)
Interest	<u>(1,706)</u>
Income before income taxes	<u>\$1,815</u>

The "Realized gross profit on installment receivables" is a non-recurring credit resulting from the allocation of Cerro-Marmon's purchase cost to the real estate subsidiaries' net assets. Income taxes in the condensed consolidated statement of income of Cerro-Marmon include a charge equal to the non-recurring credit.

Leadership participates in four joint ventures. Two of these joint ventures are with certain Pritzker Trusts (the Pritzker family, through trusts and other entities own all of the outstanding capital stock of GL) and provide for Leadership's participation in 50% of the profits and losses. These two ventures hold unimproved property and have not made any sales. While Leadership has no investment in these particular ventures, it is contingently liable to lenders for approximately \$19,200,000 of notes payable by the joint ventures. Leadership, however, would have recourse to the joint ventures. At March 31, 1977, approximately \$18,200,000 of such debt of one of the joint ventures was in default and actions for foreclosures had been filed by certain noteholders. The ultimate exposure to Leadership of these contingencies cannot be determined and no provision has been included in the financial statements as of March 31, 1977.

At March 31, 1977, Leadership's indebtedness included an unsecured, non-interest bearing note having a face value of \$12,000,000, due \$3,000,000 annually commencing in December 1977, guaranteed by Cerro-Marmon.

LS 000883

## 6. Income taxes

Cerro-Marmon will be included in the consolidated federal income tax returns of GL. Prior to February 25, 1976, Marmon was included in GL's consolidated federal income tax returns. Pursuant to a formal tax sharing agreement with GL, federal income taxes of Cerro-Marmon will be determined, in general, as if the former Cerro affiliated tax group and the former Marmon affiliated tax group each filed separate consolidated tax returns. Prior to February 25, 1976, federal income taxes of Marmon were determined, in general, as if Marmon and its domestic subsidiaries filed a separate consolidated federal income tax return. Federal income taxes so determined are to be paid periodically to GL except that (1) the former Cerro affiliated tax group shall not be required to make any tax sharing payments during any taxable period in which Cerro-Marmon has not currently paid all prescribed dividends or made sinking fund payments on its Series A preferred stock and (2) during all other taxable periods the former Cerro affiliated group shall retain, without restriction, 50% of any tax sharing payments that would be due to any member of the GL affiliated group. No income taxes are payable to GL by the former Cerro affiliated group. As a member of the GL consolidated federal income tax group, Cerro-Marmon (and Marmon prior to February 25, 1976) is contingently liable for the federal income taxes of the other members of the group. GL has indemnified Cerro-Marmon (and Marmon) for any federal income taxes attributable to other members of the group.

Examinations by the Internal Revenue Service (Service) of Cerro's federal income tax returns for the years 1965 through 1971 have been substantially completed and additional liabilities have been proposed by the Service. The Service is in the initial stages of an examination of Cerro's federal income tax returns for the years 1972 through 1974 and has not progressed sufficiently to form any conclusions relating to matters reflected in such returns. Cerro's returns include the effects of complex transactions among which is the 1974 expropriation of Cerro's subsidiary, Cerro de Pasco (C de P), discussed below.

On January 1, 1974, C de P was expropriated by the Peruvian government, resulting in a loss of \$135,000,000 which was reflected in Cerro's federal income tax return for 1974. On January 22, 1974, the Service advised Cerro by a private ruling letter that it considered the 1974 C de P expropriation loss to have resulted from a compulsory or involuntary conversion of the stock of C de P and that the loss qualified as an ordinary loss which would be carried over and applied against the Cerro affiliated group income for as long as ten years to the extent not utilized during the taxable year in which it arose. By letter dated May 12, 1976, the Service advised Cerro-Marmon that the January 22, 1974 ruling letter was being retroactively revoked with respect to the conclusion that the loss was an involuntary conversion of the stock of C de P and held that the transaction will be treated as an expropriation of assets. During the course of the current examination of Cerro's federal tax returns, the Service has insisted upon physically examining the books and records of C de P in Peru in order to verify the basis of C de P's assets. To date the Service has not received permission from the Government of Peru to conduct the examination in Peru. Nevertheless, present management believes that the adjusted basis of C de P's assets ultimately can be established.

On the basis of presently known information, Cerro-Marmon's management, who were not part of the Cerro management in 1974 or prior years, believe (1) that adequate provision has been made for additional liabilities that may be assessed

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for the years 1965 through 1971, (2) that no significant change will be made in Cerro's federal income tax position for the periods subsequent to 1971 from that reflected on Cerro's income tax returns for such periods, and (3) that the federal income tax benefits available to Cerro-Marmon from prior losses of Cerro, which are estimated to be in excess of \$18,000,000 at March 31, 1977, will be realized. However, as a result of the uncertainties raised by the retroactive revocation of the January 22, 1974 ruling letter, the present inability to obtain permission from the Government of Peru for the Service to travel to Peru and the matters discussed in Note 2, conservative accounting practice dictates that recognition of the income tax benefits of the prior Cerro losses be deferred until all significant matters relating to Cerro's prior year income tax position are resolved. See Note 2 as to Cerro-Marmon's accounting for income tax benefits of Cerro's prior losses when such benefits are realized.

#### 7. Employment Contract Settlement

In the first quarter of 1977, Cerro-Marmon negotiated the termination of long-term employment and other related contracts with certain officers of a coal mining subsidiary. The cost of this settlement of approximately \$4,700,000 is reflected in "Miscellaneous - net" in the accompanying condensed consolidated statement of income for the three months ended March 31, 1977. This settlement reduced net income for the three months ended March 31, 1977 by approximately \$3,200,000.

#### 8. Litigation

All significant litigation matters relating to Cerro-Marmon and the merger of Cerro into Cerro-Marmon described in the notes to the 1976 consolidated financial statements included on Form 10-K for the year ended December 31, 1976 have been settled and dismissed on the basis described therein. Other litigation will not have a material adverse effect on the accompanying condensed consolidated financial statements.

#### 9. Quarterly Data

The condensed consolidated statement of income for the three months ended March 31, 1976 has been restated as follows:

	<u>As Previously Reported</u>	<u>As Restated</u>
Revenues	\$203,496	\$194,662
Cost of sales	178,562	170,914
Income before income taxes, equity in net income of Cerro and discontinued business	12,394	11,715
Income from continuing operations	7,906	8,159
Net income	7,906	8,878

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The restated amounts shown above reflect restatements for (1) amounts applicable to the trucking subsidiary classified as a discontinued operation in the fourth quarter of 1976, (2) reclassifications to cost of sales of certain amounts improperly included in revenues, (3) adjustments to reflect the effects of changes in purchase cost allocations from the initial tentative allocations made in the first quarter and (4) retroactive reflection of certain inventory adjustments determined in the fourth quarter of 1976 that were applicable to prior quarters. The effects of these retroactive adjustments have been reflected in the condensed consolidated balance sheet at March 31, 1976 and the condensed consolidated statement of changes in financial position for the three months then ended.

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# MANAGEMENT'S DISCUSSION AND ANALYSIS OF QUARTERLY RESULTS

The comparability of the historical condensed consolidated statements of income for the three months ended March 31, 1977 and 1976 is significantly affected by the merger of Cerro Corporation into Cerro-Marmon Corporation on February 24, 1976 as described in the notes to the condensed consolidated financial statements. Therefore, to facilitate a comparison, the following data for the three months ended March 31, 1976 is presented on a pro forma basis, assuming that the merger of Cerro had occurred on January 1, 1976 (in millions of dollars):

	<u>Three Months Ended March 31,</u>		<u>Three Months Ended</u>
	<u>1977</u>	<u>1976</u>	<u>December 31, 1976</u>
	(Pro forma)		
Net sales:			
Manufacturing	\$188.6	\$158.3	\$146.6
Metal trading	98.2	100.6	33.0
Coal mining	22.2	15.8	26.9
	<u>\$309.0</u>	<u>\$274.7</u>	<u>\$206.5</u>
Income from continuing operations, before income taxes:			
Manufacturing	\$ 18.3	\$ 15.4	\$ 6.4
Metal trading	2.7	2.1	1.5
Coal mining (A)	(2.5)	1.1	4.6
Real estate (B)	1.8		
Other - net (C)	.8	.1	(1.0)
Income from continuing operations, before income taxes	21.1	18.7	11.5
Income taxes (B)	<u>12.6</u>	<u>8.0</u>	<u>4.8</u>
Income from continuing operations	8.5	10.7	6.7
Income of discontinued business less income taxes	<u>.5</u>	<u>.8</u>	<u>.5</u>
Net income (A)	<u>\$ 9.0</u>	<u>\$ 11.5</u>	<u>\$ 7.2</u>

- (A) 1977 includes an unusual charge of \$4.7 million from termination of long-term employment and other related contracts (Note 7 to Condensed Consolidated Financial Statements) which charge reduced net income by \$3.2 million.
- (B) 1977 amount for real estate includes an unusual credit of \$3.5 million and income taxes include a charge of an equal amount (Note 5 to Condensed Consolidated Financial Statements).
- (C) Includes interest expense, unallocated home office expenses and miscellaneous income and expenses.

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Comparison of results for the quarter ended March 31, 1977  
with the pro forma results for the quarter ended March 31, 1976

Sales

Total sales increased \$34.3 million or 12%.

The increase of \$30.3 million related to the manufacturing operations, includes \$18 million from the acquired Hammond operations from January 27, 1977. Other significant reasons for the increase in sales of the manufacturing group were improved demand in tubing, metal products and wire and cable reflecting better economic conditions in the residential housing and general industrial markets; selling prices were increased in applicable operating units as the basic price of copper increased; and there was an improved demand for automobiles and trucks which resulted in an increase in the automotive products group sales with truck flat leaf springs being a major factor.

Coal mining sales increases reflect increased tonnage shipped to domestic users in 1977.

Sales of the nonconsolidated real estate subsidiaries for the first quarter of 1977 were \$5 million compared to \$8 million in the comparable 1976 quarter. Such sales are not included in consolidated net sales shown above as the real estate subsidiaries are accounted for on the equity method.

Income from continuing operations

Income from continuing operations before income taxes increased \$2.4 million or 13%.

The increase of \$2.9 million in manufacturing income includes \$1.6 million from the Hammond operations for the period subsequent to acquisition, and increases in the income of the pipe and tubing and metal products groups due principally to increases in copper prices in 1977. Automotive products group income increased due to higher sales volume. These increases were partially offset by lower income from the mining equipment operations which continues to be impacted by declining sales and gross margins caused by reduced demand for mining equipment. Also, wire and cable operations, while benefiting from higher prices in the first quarter of 1977, were still operating under reduced gross margins from abnormally low pricing carried over from 1976.

Metal trading income improved principally because of reduced interest rates on borrowings incurred to finance inventories. There was also increased activity and income from agency commissions.

Income from coal mining operations increased \$1.1 million to \$2.2 million in 1977 before the \$4.7 million unusual charge resulting from the termination of long-term employment and other related contracts (Note 7 to Condensed Consolidated Financial Statements). This increase in income results principally from higher sales volume.

The real estate subsidiaries incurred a loss of \$1.7 million in 1977 before an unusual credit of \$3.5 million from the realization of gross profit on installment receivables. The loss of the real estate subsidiaries in 1976 was charged to a reserve established therefor in the purchase cost allocation (Note 5 to Condensed Consolidated

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Financial Statements); therefore, no amount is included in the pro forma results for the first quarter of 1976.

Other - net was income of \$.8 million in 1977 compared with \$.1 million in 1976. The 1976 amount includes a \$.4 million loss relating to certain operations subsequently sold. The remainder of the increase relates principally to reduced home office expense.

#### Income taxes

The effective income tax rate for the first quarter, 1977 is 60% as compared to 43% for the first quarter, 1976. The increase is principally due to the inclusion of a \$3.5 million charge relating to the unusual real estate credit (Note 5 to Condensed Consolidated Financial Statements), and an expected higher effective tax rate in 1977.

Comparison of the results for the first quarter of 1977  
with the results for the preceding quarter ended December 31, 1976

#### Sales

Total sales increased \$102.5 million or 50%.

The increase of \$42 million from manufacturing operations included \$18 million relating to the acquired Hammond operations from January 27, 1977. Other significant changes in sales of the manufacturing operations included an increase in tubing and metal products where a combination of reduced seasonal demand and declining prices related to lower basic metal costs (primarily copper) was present in the fourth quarter of 1976 versus a counter trend in 1977. Automotive sales in the 1977 quarter increased from the 4th quarter of 1976 due to the elimination of holidays occurring in the fourth quarter and improved demand for product in the truck flat leaf spring markets. Mining equipment reflected an increase in sales in the 1977 quarter as a result of the first signs of improved demand in this area.

Metal trading sales increased \$65.2 million due principally to the delivery of copper under advanced sales contracts entered into in December 1976.

Coal mining sales decreased due principally to the elimination of a subsidiary resulting from the termination of long-term employment and other related contracts.

#### Income from continuing operations

Income from continuing operations before income taxes increased \$9.6 million or 83%.

The increase of \$11.9 million in manufacturing income includes \$1.6 million from the Hammond operations for the period subsequent to acquisition and substantial increases in income from the pipe and tubing, metal products and wire and cable operations resulting principally from the turn around of copper prices. Copper prices declined in the fourth quarter of 1976 resulting in reduced gross margins and inventory write downs in that quarter. Increased prices in the first quarter of 1977 resulted in improved margins and partial recoveries of the previously reflected inventory losses. Income from the automotive products group increased due primarily to the increased demand for truck flat leaf springs. Mining equipment income was up due to the increased sales volume in the 1977 quarter and the absence of development and other costs incurred in 1976.

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Metal trading income increased \$1.2 million reflecting lower interest costs to finance inventories, increased physical sales with resultant higher agency commissions as well as a more active market in the first quarter of 1977 resulting in improved trading results.

Coal mining income, before the unusual charges discussed previously, decreased \$2.4 million reflecting lower sales volume and reduced margins.

No amount was included for the real estate subsidiaries in 1976 as discussed previously.

Other - net was income of \$.8 million in 1977 compared with expense of \$1 million in 1976. The change is due principally to pension expense applicable to terminated foreign employees that was recorded in 1976.

#### Income taxes

The effective tax rate for 1977 is 60% as compared to a rate of 42% in 1976. The increase in the effective rate is principally due to the matters discussed in the comparison of first quarter results for 1976 and 1977.

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Part II - Other Information

Item 1. Legal Proceedings

See the discussion in Note 8 of Condensed Notes to the Condensed Consolidated Financial Statements in Part I of this Form 10-Q.

Item 9(b) Exhibits and Reports on Form 8-K

No reports on Form 8-K were required to be filed for the three months ended March 31, 1977.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CERRO-MARMON CORPORATION

Registrant

DATE: 5/17/77

RC Gluth  
R. C. Gluth, Executive Vice President

DATE: 5/17/77

T. L. Seifert  
T. L. Seifert, Secretary

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended June 30, 1977 Commission File Number 1-7285

The Marmon Group, Inc.  
(Exact name of registrant as specified in its charter)

Delaware 52-104-5483  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

39 South LaSalle Street, Chicago, Illinois 60603  
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code (312) 372-9500

Cerro-Marmon Corporation  
Former name, former address and former fiscal year, if changed  
since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No     

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of the period covered by this report.

5,000,000 shares of Common Stock were issued and outstanding  
at June 30, 1977.

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THE MARMON GROUP, INC.  
CONDENSED CONSOLIDATED BALANCE SHEET  
(In thousands of dollars)  
(Unaudited)

	June 30,	
	1977	1976
ASSETS	(Notes 1, 2 and 9)	Restated
Current assets:		
Cash and cash equivalents	\$ 16,653	\$ 25,066
Marketable securities	5,076	17,249
Receivables - net	148,286	123,254
Inventories (Note 3)	266,762	170,883
Other current assets	8,071	8,771
Total current assets	444,848	345,223
Investments in and advances to nonconsolidated subsidiaries:		
Trucking (Note 4)	18,264	15,857
Realty (Note 5)	16,933	19,669
Notes due from Chile	2,587	5,749
Property, plant and equipment - net	105,034	99,826
Other investments and assets	17,572	15,704
	<u>\$605,238</u>	<u>\$502,028</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Notes payable to banks	\$ 60,364	\$ 18,322
Long-term obligations due in one year	13,498	13,620
Accounts payable	63,419	55,495
Income taxes (Note 6)	25,761	20,875
Accrued liabilities	45,778	34,199
Total current liabilities	208,820	142,511
Long-term obligations	96,932	129,841
Deferred credit from acquisition (Note 2)	20,811	7,307
Other non-current amounts	16,356	12,219
Contingencies (Notes 2 and 8)		
Total liabilities	<u>342,919</u>	<u>291,878</u>
Shareholders' equity:		
Preferred stock, liquidation preference and redemption value of \$93,699	89,770	88,724
Common stock	5,000	5,000
Other paid-in capital	26,489	10,241
Retained earnings	141,060	106,185
Total shareholders' equity	<u>262,319</u>	<u>210,150</u>
	<u>\$605,238</u>	<u>\$502,028</u>

See Condensed Notes to Condensed Consolidated Financial Statements.

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THE MARMON GROUP, INC.

CONDENSED CONSOLIDATED STATEMENT OF INCOME

(In thousands of dollars)  
(Unaudited)

	Three Months Ended June 30,	
	1977	1976
	(Notes 1, 2 and 9)	Restated (Notes 1, 2 and 9)
Revenues:		
Net sales	\$286,624	\$217,886
Miscellaneous - net (Notes 5 and 7)	<u>1,781</u>	<u>3,302</u>
	<u>288,405</u>	<u>221,188</u>
Costs and expenses:		
Cost of sales	235,094	183,973
Selling and administrative	22,234	14,516
Interest	<u>4,021</u>	<u>3,509</u>
	<u>261,349</u>	<u>201,998</u>
Income before income taxes and discontinued business	27,056	19,190
Income taxes (Notes 5 and 6)	<u>13,267</u>	<u>8,176</u>
Income from continuing operations	13,789	11,014
Income of discontinued business less income taxes (Note 4)	<u>902</u>	<u>1,179</u>
Net income	14,691	12,193
Net income applicable to preferred stock	<u>(2,657)</u>	<u>(2,694)</u>
Net income applicable to common stock	<u>\$ 12,034</u>	<u>\$ 9,499</u>

See Condensed Notes to Condensed Consolidated Financial Statements.

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THE MARMON GROUP, INC.

CONDENSED CONSOLIDATED STATEMENT OF INCOME

(In thousands of dollars)  
(Unaudited)

	Six Months Ended June 30,		
	1977	1976	
	Historical	Restated	Pro Forma
	(Notes 1, 2 and 9)		
Revenues:			
Net sales	\$595,600	\$411,291	\$491,463
Miscellaneous - net (Notes 5 and 7)	<u>2,859</u>	<u>4,559</u>	<u>6,565</u>
	<u>598,459</u>	<u>415,850</u>	<u>498,028</u>
Costs and expenses:			
Cost of sales	501,071	354,887	423,683
Selling and administrative	42,053	24,412	29,369
Interest	<u>7,165</u>	<u>5,646</u>	<u>7,042</u>
	<u>550,289</u>	<u>384,945</u>	<u>460,094</u>
Income before amounts shown below	48,170	30,905	37,934
Income taxes (Notes 5 and 6)	<u>25,822</u>	<u>13,168</u>	<u>16,356</u>
Income before equity in net income of Cerro Corporation and discontinued business	22,348	17,737	21,578
Equity in net income from continuing operations of Cerro Corporation (Note 1)	<u>          </u>	<u>1,436</u>	<u>          </u>
	22,348	19,173	21,578
Income of discontinued business less income taxes (Note 4)	<u>1,418</u>	<u>1,898</u>	<u>1,944</u>
Net income	23,766	21,071	23,522
Net income applicable to preferred stock	<u>(5,314)</u>	<u>(3,743)</u>	<u>(5,219)</u>
Net income applicable to common stock	<u>\$ 18,452</u>	<u>\$ 17,328</u>	<u>\$ 18,303</u>

See Condensed Notes to Condensed Consolidated Financial Statements.

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THE MARMON GROUP, INC.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (NOTES 1 AND 2)

Six Months Ended June 30, 1977

(In thousands of dollars)  
(Unaudited)

	Preferred Stock	Common Stock	Other Paid-In Capital	Retained Earnings	Total
Balance at December 31, 1976	\$ 89,248	\$ 5,000	\$ 10,241	\$ 122,608	\$ 227,097
Net income				23,766	23,766
Preferred dividends paid				(4,792)	(4,792)
Contribution by GL (Note 1)			16,248		16,248
Accrual of redemption value of preferred stock	522			(522)	
Balance at June 30, 1977	\$ 89,770	\$ 5,000	\$ 26,489	\$ 141,060	\$ 262,319

See Condensed Notes to Condensed Consolidated Financial Statements.

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THE MARMON GROUP, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES  
IN FINANCIAL POSITION (NOTES 1 and 2)

Six Months Ended June 30, 1977

(In thousands of dollars)

(Unaudited)

Sources of working capital:

Total provided by continuing operations	\$ 41,436	
Total provided by discontinued operations	<u>163</u>	
Total provided by operations		\$ 41,599

Acquisition of Hammond -

Capital contribution by GL, less \$2,997 assigned to net non-current assets	13,251	
Working capital received of \$18,321 less cost of net assets acquired	<u>310</u>	
Total resulting from acquisition of Hammond		13,561

Proceeds from long-term obligations	3,650	
Other - net	<u>827</u>	

Total working capital provided 59,637

Dispositions of working capital:

Additions to property, plant and equipment - net	8,152	
Reduction in long-term obligations	5,659	
Preferred dividends paid	<u>4,792</u>	
Total working capital used		<u>18,603</u>

Increase in working capital 41,034  
Working capital at December 31, 1976 194,994

Working capital at June 30, 1977 \$ 236,028

See Condensed Notes to Condensed Consolidated Financial Statements.

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THE MARMON GROUP, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES  
IN FINANCIAL POSITION (RESTATED) (NOTES 1 and 2)

Six Months Ended June 30, 1976  
(In thousands of dollars)  
(Unaudited)

Sources of working capital:		
Total provided by continuing operations	\$ 24,826	
Total provided by discontinued operations	<u>820</u>	
Total provided by operations		\$ 25,646
Merger of Cerro at February 24, 1976 -		
Preferred stock issued and issuable	88,375	
Marmon's basis in 45.33% of Cerro	80,028	
Long-term obligations assumed	84,104	
Other - net	<u>18,248</u>	
	<u>270,755</u>	
Less cost assigned to non-current assets	<u>108,420</u>	
Total provided by merger of Cerro		162,335
Proceeds from long-term obligations		1,325
Decrease in Chilean notes		<u>9,338</u>
Total working capital provided		198,644
Dispositions of working capital:		
Additions to property, plant and equipment - net	8,012	
Reduction in long-term obligations	36,988	
Increase in other investments and assets	4,534	
Advances to real estate subsidiary	4,725	
Preferred dividends paid	3,395	
Other - net	<u>568</u>	
Total working capital used		<u>58,222</u>
Increase in working capital		140,422
Working capital at December 31, 1975		<u>62,290</u>
Working capital at June 30, 1976		<u>\$ 202,712</u>

See Condensed Notes to Condensed Consolidated Financial Statements.

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THE MARMON GROUP, INC.

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 1977 and 1976

(Tabular amounts are in thousands of dollars)

(Unaudited)

The accompanying condensed consolidated financial statements, which are for interim periods, do not include all disclosures provided in annual financial statements. Reference is made to the consolidated financial statements and related notes thereto included in the annual report on Form 10-K filed by Cerro-Marmon Corporation (Cerro-Marmon) with the Securities and Exchange Commission for the year ended December 31, 1976.

The accompanying condensed consolidated financial statements include all adjustments, consisting only of normal recurring accruals except for a charge to income relating to the termination of long-term employment and other related contracts (Note 7) and resolution of an uncertainty relating to the real estate operations (Note 2) in the six months ended June 30, 1977, which, in the opinion of management, are necessary for a fair presentation of the condensed consolidated statements of financial position, results of operations and changes in financial position.

1. Organization and Basis of Financial Statements

Pursuant to a vote of shareholders taken on June 3, 1977, the name of the corporation was changed from Cerro-Marmon Corporation to The Marmon Group, Inc. (Marmon).

Cerro-Marmon was inactive until February 24, 1976. On that date Cerro-Marmon acquired from its parent, GL Corporation (GL), (1) all of the outstanding capital stock of The Marmon Group, Inc. (Michigan) (TMG), including TMG's 45.33% equity interest in Cerro Corporation (Cerro) acquired in 1974, in a transaction accounted for as if it was a pooling of interest and (2) the remaining 54.67% equity interest in Cerro in a transaction accounted for as a purchase. As a result of these transactions, GL owns 100% of the common stock of Marmon, which represents approximately 82% of the total voting interest in Marmon. Accordingly, the consolidated financial statements of Marmon prior to February 25, 1976 consist of the consolidated financial statements of TMG, Marmon's accounting predecessor company, and all subsidiaries, including TMG's 45.33% interest in Cerro accounted for on an equity basis. Commencing February 25, 1976 the consolidated financial statements consist of the financial statements of Marmon and all significant subsidiaries except the real estate subsidiaries and the trucking subsidiary which is to be sold (Note 4).

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The acquisition of Cerro has been accounted for as a purchase. Accordingly, the net assets of the business formerly conducted by Cerro are included at amounts determined after giving effect to an allocation of the purchase cost to such net assets. The effect of the purchase cost allocations was to significantly reduce the amounts at which Cerro's net assets are included in the Marmon condensed consolidated balance sheet from amounts previously reflected in Cerro's historical consolidated balance sheet. Reductions were made principally to investments (including the investment in the real estate subsidiaries), property, plant and equipment, intangible assets and the asset included in the Cerro balance sheet for future income tax benefit. This allocation and the effects thereof on results of operations are subject to retroactive revision to reflect the resolution of certain specific matters discussed in Note 2.

The purchase cost allocations had the effect of significantly increasing the amount reflected by TMG as its equity in the net income of Cerro prior to February 25, 1976 and the net income of Marmon subsequent thereto. This effect results principally from (1) reductions in depreciation, depletion and amortization of property, plant and equipment and intangible assets, (2) larger gains or lesser losses from dispositions of assets and (3) elimination of net losses from the real estate operations for periods through December 31, 1976, as well as a June 1977 provision for estimated losses resulting from a decision by Leadership and its joint venture partner for a planned termination of the joint venture in which Leadership participates, as discussed in the following paragraphs.

No amounts have been included in consolidated results of operations applicable to the nonconsolidated real estate subsidiaries for the six months ended June 30, 1976. The loss incurred by these subsidiaries was charged to a reserve established in connection with the allocation of TMG's purchase cost to Cerro's net assets because significant uncertainties precluded such allocation to these subsidiaries at the dates of purchase. As discussed more fully in Note 5, various of the uncertainties were substantially resolved as of December 31, 1976 and a revised purchase cost allocation was made; therefore, the results of operations of the nonconsolidated real estate subsidiaries are reflected in consolidated net income, commencing January 1, 1977, on the equity method. Reference is also made to Note 5 with respect to certain guarantees by Leadership relating to a joint venture in which Leadership participates.

Had the merger of Cerro into Marmon been consummated on January 1, 1976, pro forma revenue and net income for the six months ended June 30, 1976 would have been as follows:

Revenues	<u>\$498,028</u>
Income from continuing operations	\$ 21,578
Income from discontinued business	<u>1,944</u>
Net income	<u>\$ 23,522</u>

The above pro forma amounts consist of the historical amounts applicable to TMG and Cerro for the period January 1, 1976 to February 24

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1976, adjusted on a pro forma basis to give effect to the adjustments resulting from the merger of Cerro into Marmon, and the reported amounts applicable to Marmon for the period subsequent to the merger date, both adjusted to reflect the discontinuance of trucking operations. As noted above, no amounts are included for the real estate subsidiaries.

On January 26, 1977 Marmon (1) received 48% of the outstanding common stock of Hammond Corporation (Hammond) as a capital contribution from GL and (2) acquired the remaining equity interest in Hammond for cash of approximately \$18,000,000. The acquisition of Hammond has been accounted for as a purchase and the results of operations of Hammond have been included in the condensed consolidated financial statements commencing January 27, 1977. Had the acquisition of Hammond taken place on January 1, 1976, Marmon's consolidated revenues and net income on a pro forma basis, after giving effect to a preliminary allocation of Marmon's accounting basis in Hammond to Hammond's net assets, would have increased by:

	Quarter Ended June 30, <u>1976</u>	Six Months Ended June 30, <u>1977</u>	<u>1976</u>
Revenues	\$ 17,992	\$ 10,993	\$ 50,914
Net income	317	551	843

## 2. Uncertainties

Significant uncertainties, relating to the former Cerro operations, existed at February 24, 1976. Such uncertainties related principally to the real estate operations (Leadership). Various of the uncertainties were substantially resolved at December 31, 1976. The major remaining uncertainty related to the net realizable value of a joint venture in which Leadership participates (Note 5).

Income tax matters, including matters relating to Cerro's prior year federal income tax position, are discussed in Note 6. On the basis of presently known information, management of Marmon does not anticipate any significant change in the prior year federal income tax position of Cerro from that reflected in Cerro's income tax returns other than as previously provided. Further, Marmon's management anticipates that the amount of future income tax benefit available from Cerro's prior year losses will be ultimately realized. However, because of the complexities of the matters and because no member of Marmon's management was a part of Cerro's management prior to 1975, Marmon will continue to include all income tax benefits realized from prior year losses of Cerro in the "Deferred credit from acquisition" in the Marmon consolidated balance sheet (rather than being partially applied to reduce the purchase cost allocated to Cerro's former property, plant and equipment) and to reflect no amortization of the deferred credit in income until the matters referred to above, including the matter relating to Leadership, are resolved. The effect thereof on the accompanying condensed consolidated financial statements is not material. Upon resolution, the purchase cost allocated to Cerro's net assets will be retroactively revised to reflect any adjustments resulting from (1) the realization of the income tax benefits result-

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ing from prior year losses of Cerro and (2) the outcome of the matters discussed above relating to Leadership and the prior year federal income tax position of Cerro. Further, provisions for depreciation and depletion will be retroactively adjusted to reflect the effects of any revision of purchase cost allocated to property, plant and equipment and amortization of any deferred credit will be retroactively included in income. Any retroactive adjustments required will not have a material effect on consolidated working capital and shareholders' equity at June 30, 1977 and 1976.

### 3. Inventories

	June 30,	
	<u>1977</u>	<u>1976</u>
Metal trading inventories	\$ 69,980	\$ 31,391
Coal inventories and supplies	11,208	10,435
Manufacturing inventories and supplies	<u>185,574</u>	<u>129,057</u>
	<u>\$266,762</u>	<u>\$170,883</u>

Inventories valued under the LIFO method were approximately \$31,500,000 less than the current costs of such inventories at June 30, 1977 (\$27,000,000 at June 30, 1976). The classification of manufacturing inventories by stage of production is not available from the accounting records.

### 4. Investment in Trucking Subsidiary

Marmon intends to sell, in the third quarter of 1977, its majority owned trucking subsidiary, ICX Industries, Inc., to ICX Corporation, a corporation formed by certain employees of the trucking subsidiary, for \$22,600,000 in cash, a subordinated note of approximately \$5,500,000 (subject to changes in the net asset value of the subsidiary to date of sale), which bears interest at prime plus 4½% per annum, and a 19.8% equity interest in ICX Corporation. Accordingly, the trucking subsidiary is reflected in the financial statements as a discontinued business. The gain to be realized on the sale, before income taxes, is estimated at approximately \$4 million based on the cash proceeds to be received. The gain represented by the notes and stock will be recognized as amounts are realized in cash.

Net assets of the discontinued trucking business, after giving effect to Marmon's purchase cost allocations, at June 30, 1977 follow:

Current assets	\$ 9,972
Current liabilities	<u>8,663</u>
Net current assets	1,309
Property and equipment - net	13,371
Operating rights and other assets	6,775
Non-current obligations	<u>(3,191)</u>
Net assets	<u>\$ 18,264</u>

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The amounts shown in the consolidated statement of income as income of discontinued business for the period January 1, 1976 to February 24, 1976 consist of TMG's 45.33% equity in the net income of Cerro's trucking subsidiary, less TMG's income taxes relating thereto, and for periods subsequent thereto consist of the adjusted income of the trucking subsidiary, less related income taxes.

For the six month periods ended June 30, 1977 and 1976 ICX Industries, Inc. reported revenues of \$43,666,000 and \$41,709,000, respectively. Revenues for the three month period ended June 30, 1977 were \$22,966,000 compared to \$21,139,000 in the comparable 1976 period.

##### 5. Investment in Real Estate Subsidiaries

No amounts have been included in the condensed consolidated results of operations applicable to real estate subsidiaries for the six months ended June 30, 1976 as the loss incurred by these subsidiaries was charged to a reserve established for such purpose by the initial purchase cost allocations. This reserve was established because various uncertainties relating to the real estate operations precluded an allocation of purchase cost to the real estate assets at the dates of acquisition of Cerro. Certain of these uncertainties were substantially resolved by the modification of certain agreements and restructuring of debt obligations concluded in February 1977, the reductions in inventories and the restructuring of the activities of the real estate subsidiaries, and the general improvement in the market in the various areas in which the real estate operations are conducted. The most significant remaining uncertainty relates to a joint venture in which Leadership is a participant (see the third paragraph of this note). The above-described events permitted a quasi-reorganization of Leadership as of December 31, 1976 at which date its assets were revalued to reflect their fair market values. These revised asset values were used as the basis for finalizing the purchase cost allocation to the real estate assets and to Marmon's investment in the real estate subsidiaries. Commencing January 1, 1977, Marmon has reflected its equity in the operating results of the real estate subsidiaries in the condensed consolidated financial statements. A condensed combined statement of operations, exclusive of the effects of the quasi-reorganization and debt restructuring which were reflected as of December 31, 1976 and after giving effect to adjustments relating to the purchase cost allocation, for the six months ended June 30, 1977 follows:

Sales	\$ 18,932
Interest and other revenue	932
Realized gross profit on installment receivables	3,467
Cost and expenses:	
Cost of sales	(17,755)
Selling and administrative	(1,801)
Interest	(2,931)
Income before income taxes	<u>\$ 844</u>

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The "Realized gross profit on installment receivables" is a non-recurring credit resulting from the allocation of Marmon's purchase cost to the real estate subsidiaries' net assets. Income taxes in the condensed consolidated statement of income of Marmon include a charge equal to the non-recurring credit.

Leadership participates in four joint ventures. Two of these joint ventures are with certain Pritzker Trusts (the Pritzker family, through trusts and other entities, own all of the outstanding capital stock of GL) and provide for Leadership's participation in 50% of the profits and losses. These two joint ventures hold unimproved property and have not made any sales. While Leadership has no investment in these particular ventures, it was contingently liable to lenders for approximately \$13,200,000 of notes payable by the joint ventures. At June 30, 1977, approximately \$12,500,000 of such debt of one of the joint ventures was in default and actions for foreclosures had been filed by certain noteholders. As a result of the foreclosure actions, negotiations with the noteholders and a joint valuation by the partners, a decision was made by Leadership and the joint venture partner to minimize the potential loss in the joint venture through a plan to terminate the joint venture and return the properties to the noteholders. Leadership has made a provision of \$6,500,000 for 50% for its estimated loss relating to this joint venture. The provision has been charged to "Deferred credit from acquisition" in the accompanying condensed consolidated financial statements. The joint venture is contingently liable for deficiency judgments, if any, that may be obtained by the noteholders, but in the opinion of management, such liability would have no material affect on the consolidated financial statements of Marmon.

At June 30, 1977, Leadership's indebtedness included an unsecured, non-interest bearing note having a face value of \$12,000,000, due \$3,000,000 annually commencing in December 1977, guaranteed by Marmon.

#### 6. Income taxes

Marmon will be included in the consolidated federal income tax returns of GL. Prior to February 25, 1976, TMG was included in GL's consolidated federal income tax returns. Pursuant to a formal tax sharing agreement with GL, federal income taxes of Marmon will be determined, in general, as if the former Cerro affiliated tax group and the former TMG affiliated tax group each filed separate consolidated tax returns. Prior to February 25, 1976, federal income taxes of TMG were determined, in general, as if TMG and its domestic subsidiaries filed a separate consolidated federal income tax return. Federal income taxes so determined are to be paid periodically to GL except that (1) the former Cerro affiliated tax group shall not be required to make any tax sharing payments during any taxable period in which Marmon has not currently paid all prescribed dividends or made sinking fund payments on its Series A preferred stock and (2) during all

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other taxable periods the former Cerro affiliated group shall retain, without restriction, 50% of any tax sharing payments that would be due to any member of the GL affiliated group. No income taxes are payable to GL by the former Cerro affiliated group. As a member of the GL consolidated federal income tax group, Marmon (and TMG prior to February 25, 1976) is contingently liable for the federal income taxes of the other members of the group. GL has indemnified Marmon (and TMG) for any federal income taxes attributable to other members of the group.

Examinations by the Internal Revenue Service (Service) of Cerro's federal income tax returns for the years 1965 through 1971 have been substantially completed and additional liabilities have been proposed by the Service. The Service is in the initial stages of an examination of Cerro's federal income tax returns for the years 1972 through 1974 and has not progressed sufficiently to form any conclusions relating to matters reflected in such returns. Cerro's returns include the effects of complex transactions among which is the 1974 expropriation of Cerro's subsidiary, Cerro de Pasco (C de P), discussed below.

On January 1, 1974, C de P was expropriated by the Peruvian government, resulting in a loss of \$135,000,000 which was reflected in Cerro's federal income tax return for 1974. On January 22, 1974, the Service advised Cerro by a private ruling letter that it considered the 1974 C de P expropriation loss to have resulted from a compulsory or involuntary conversion of the stock of C de P and that the loss qualified as an ordinary loss which would be carried over and applied against the Cerro affiliated group income for as long as ten years to the extent not utilized during the taxable year in which it arose. By letter dated May 12, 1976, the Service advised Marmon that the January 22, 1974 ruling letter was being retroactively revoked with respect to the conclusion that the loss was an involuntary conversion of the stock of C de P and held that the transaction will be treated as an expropriation of assets. During the course of the current examination of Cerro's federal tax returns, the Service has insisted upon physically examining the books and records of C de P in Peru in order to verify the basis of C de P's assets. To date the Service has not received permission from the Government of Peru to conduct the examination in Peru. Nevertheless, present management believes that the adjusted basis of C de P's assets ultimately can be established.

On the basis of presently known information, Marmon's management, who were not part of the Cerro management in 1974 or prior years, believe (1) that adequate provision has been made for additional liabilities that may be assessed for the years 1965 through 1971, (2) that no significant change will be made in Cerro's federal income tax position for the periods subsequent to 1971 from that reflected on Cerro's income tax returns for such periods, and (3) that the federal income tax benefits available to Marmon from prior losses of Cerro, which are estimated to be in excess of \$11,000,000 at June 30, 1977, will be realized. However, as a result of the uncertainties raised by the retroactive revocation of the January 22, 1974 ruling letter, the present inability to obtain permission from the Government of Peru for the Service to travel to Peru and the matters discussed

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in Note 2, conservative accounting practice dictates that recognition of the income tax benefits of the prior Cerro losses be deferred until all significant matters relating to Cerro's prior year income tax position are resolved. See Note 2 as to Marmon's accounting for income tax benefits of Cerro's prior losses when such benefits are realized.

#### 7. Employment Contract Settlement

In the first quarter of 1977, Marmon negotiated the termination of long-term employment and other related contracts with certain officers of a coal mining subsidiary. The cost of this settlement of approximately \$4,700,000 is reflected in "Miscellaneous - net" in the accompanying condensed consolidated statement of income for the six months ended June 30, 1977. This settlement reduced net income for the six months ended June 30, 1977 by approximately \$3,200,000.

#### 8. Litigation

All significant litigation matters relating to Marmon and the merger of Cerro into Marmon described in the notes to the December 31, 1976 consolidated financial statements included in Form 10-K have been settled and dismissed on the basis described therein. Other litigation will not have a material adverse effect on the accompanying condensed consolidated financial statements.

#### 9. Quarterly Data

The condensed consolidated statements of income for 1976 have been restated as follows:

	<u>Three Months Ended June 30, 1976</u>		<u>Six Months Ended June 30, 1976</u>	
	<u>Previously Reported</u>	<u>Restated</u>	<u>Previously Reported</u>	<u>Restated</u>
Revenues	\$250,067	\$221,188	\$453,563	\$415,850
Cost of sales	207,703	183,973	386,265	354,887
Income before income taxes, equity in net income of Cerro and discontinued business	22,630	19,190	35,024	30,905
Income from continuing operations	11,621	11,014	19,527	19,173
Net income	11,621	12,193	19,527	21,071

The restated amounts shown above reflect restatements for (1) amounts applicable to the trucking subsidiary classified as a discontinued operation in the fourth quarter of 1976, (2) reclassifications to cost of sales of certain amounts improperly included in revenues, (3) adjustments to reflect the effects of changes in purchase cost allocations from the initial tentative allocations made in the

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first quarter of 1976 and (4) retroactive reflection of certain inventory adjustments determined in the fourth quarter of 1976 that were applicable to prior quarters. The effects of these retroactive adjustments have been reflected in the condensed consolidated balance sheet at June 30, 1976 and the condensed consolidated statement of changes in financial position for the six months then ended.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

The historical condensed consolidated statement of income for the six months ended June 30, 1976 is significantly affected by the merger of Cerro into Cerro-Marmon on February 24, 1976 as described in the notes to the condensed consolidated financial statements. Therefore, to facilitate a comparison, the following data for the six months ended June 30, 1976 is presented on a pro forma basis, assuming that the merger of Cerro had occurred on January 1, 1976 (in thousands of dollars):

	1977		1976	
	Quarter Ended		Quarter	Year
	3/31	6/30	Ended 6/30	To Date 6/30
				(Pro Forma)
Net Sales:				
Manufacturing	\$188,559	\$209,509	\$398,068	\$165,850
Metal trading	98,187	51,569	149,756	30,727
Coal mining	22,230	25,546	47,776	21,309
	<u>\$308,976</u>	<u>\$286,624</u>	<u>\$595,600</u>	<u>\$217,886</u>
				<u>\$491,463</u>
Income from continuing operations,				
before income taxes:				
Manufacturing	\$ 18,271	\$ 21,346	\$ 39,617	\$ 19,574
Metal trading	2,668	2,708	5,376	376
Coal mining (A)	(2,487)	3,441	954	679
Real estate (B)	1,815	(971)	844	-
Other - net (C)	847	532	1,379	(1,439)
	<u>21,114</u>	<u>27,056</u>	<u>48,170</u>	<u>19,190</u>
				<u>37,934</u>
Income taxes	<u>12,555</u>	<u>13,267</u>	<u>25,822</u>	<u>8,176</u>
				<u>16,356</u>
Income from continuing operations	<u>8,559</u>	<u>13,789</u>	<u>22,348</u>	<u>11,014</u>
				<u>21,578</u>
Discontinued operations	<u>516</u>	<u>902</u>	<u>1,418</u>	<u>1,179</u>
				<u>1,944</u>
Net income	<u>\$ 9,075</u>	<u>\$ 14,691</u>	<u>\$ 23,766</u>	<u>\$ 12,193</u>
				<u>\$ 23,522</u>

- (A) The first quarter and year to date results for 1977 include an unusual charge of \$4.7 million resulting from termination of long-term employment and other related contracts (Note 7 to Condensed Consolidated Financial Statements) which charge reduced net income by \$3.2 million.
- (B) The first quarter and year to date results for 1977 include an unusual credit of \$3.5 million and income taxes include a charge of an equal amount (Note 5 to Condensed Consolidated Financial Statements).
- (C) Includes interest expense, unallocated home office expenses, foreign dividends and miscellaneous income and expenses.

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Comparison of results for the quarter ended June 30, 1977  
with the results for the quarter ended March 31, 1977

Sales

Total sales decreased \$22.4 million or 7%.

The increase of \$21.0 million related to the manufacturing operations includes \$4.0 million from the acquired Hammond operations which were only included in the first quarter from January 27, 1977. Other major increases in the pipe and tubing, metal products and wire and cable operations are attributed to the continued improvement from early in 1977 in demand in the residential housing and general industrial markets, as well as higher copper prices which rose until late in the second quarter. There was also some seasonal improvement particularly in the building products group. The strong demand for automobiles and trucks continued and resulted in improved sales for the automotive products group.

Excluding a \$61.8 million non-recurring copper sale in the first quarter of 1977, metal trading sales increased \$15.2 million in the second quarter because of physical deliveries being accelerated in anticipation of a copper mining strike as of June 30, 1977.

Coal mining sales improvement reflects higher sales volume of 80,000 tons principally to the domestic market. Both quarters were adversely affected by a reduction in shipments to foreign markets.

Sales of the nonconsolidated real estate subsidiaries were \$13.9 million in the second quarter compared to \$5.0 million in the first quarter. Such sales are not included in consolidated net sales as the real estate subsidiaries are accounted for on the equity basis.

Income from continuing operations

Income from continuing operations before income taxes increased \$5.9 million or 28.1%.

The increase of \$3.1 million in manufacturing income includes a \$1.2 million decline in Hammond operations which can be attributed to seasonal factors. Other major increases in income in the pipe and tubing and wire and cable and metal products groups can be attributed to better margins on increased sales continuing the trend begun earlier in the year. An improving income trend related to sales volume was present in the automotive products group. There was also seasonal improvement in the building products group resulting in higher income on higher sales.

Income from coal mining operations improved due to increased domestic volume and a sales price increase in April 1977 under a long-term foreign coal contract. The first quarter of 1977 includes a \$4.7 million unusual charge resulting from the termination of long-term employment and other related contracts.

The real estate subsidiaries incurred a loss of \$1.0 million in the second quarter of 1977, compared to a \$1.7 million loss in the first quarter (before an unusual credit of \$3.5 million from the realization of gross profit on installment receivables).

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Other - net declined \$.3 million compared to the first quarter of 1977. The second quarter included dividends of \$1.0 million from foreign affiliates which was offset by a decline in interest income and non-recurring home office expenses of \$.7 million. The first quarter also included a non-recurring gain of \$.2 million from the sale of securities.

#### Income taxes

The effective income tax rate for the first quarter of 1977 is 60% compared to a 49% rate in the second quarter. The first quarter includes a \$3.5 million charge relating to an unusual real estate credit (Note 5 to Condensed Consolidated Financial Statements).

Comparison of results for the six months ended June 30, 1977  
with the pro forma results for the six months ended June 30, 1976

#### Sales

Total sales increased \$104.1 million or 21%.

The increase of \$74.0 million related to the manufacturing operations, includes \$40.6 million from the acquired Hammond operations from January 27, 1977. Other significant reasons for the increase in sales of the manufacturing group were improved demand and higher metal costs reflected in the selling prices of pipe and tubing, metal products, and wire and cable. This improved demand reflected better economic conditions in the residential housing and general industrial markets. There was also an improved demand for automobiles and trucks which resulted in an increase in the automotive products group sales with truck flat leaf springs being a major factor.

Metal trading sales increased during 1977 because of physical deliveries of copper being accelerated in anticipation of a copper mining strike as of June 30, 1977.

Coal mining sales improved due primarily to an increase of 240,000 tons in domestic shipments and two price increases in November 1976 and April 1977 relating to a long-term coal contract. This improvement was offset by a volume reduction of 75,000 tons to foreign markets - principally the Japanese steel industry.

Sales of the nonconsolidated real estate subsidiaries were \$18.9 million for the six months ended June 30, 1977 compared to \$18.1 million in the 1976 comparable period. Such sales are not included in consolidated net sales as the real estate subsidiaries are accounted for on the equity method.

#### Income from continuing operations

Income from continuing operations before income taxes increased \$10.2 million or 27%.

The increase of \$4.7 million in manufacturing income includes \$2.4 million from the Hammond operations for the period subsequent to acquisition. Increases in the income in the pipe and tubing and metal products

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group are due principally to better margins on the increased sales. Automotive products group income increased due principally to higher sales volume. These increases were partially offset by lower income from the mining equipment operations which was impacted by declining sales and gross margins caused by reduced demand for mining equipment, particularly in the first quarter of 1977. Also, wire and cable operations, while benefiting from some firmness in pricing in the residential markets, were operating under reduced gross margins from abnormally low pricing carried over from 1976.

Metal trading income improved principally because of lower interest costs on borrowings incurred to finance inventories. There was also increased activity and income from agency commissions and an active market that was favorable to arbitrage and hedged copper inventory positions.

Earnings from coal mining operations increased as a result of increased sales volume and sales price escalations in November 1976 and April 1977 under a long-term foreign coal contract. The period ended June 30, 1977 includes a \$4.7 million unusual charge resulting from the termination of long-term employment and other related contracts.

The real estate subsidiaries incurred a loss of \$2.7 million in 1977 before an unusual credit of \$3.5 million from the realization of gross profit on installment receivables. The loss of the real estate subsidiaries in 1976 was charged to a reserve established in the purchase cost allocation; therefore, no amount is included in the pro forma results for the six months ended June 30, 1976.

Other-net improved \$2.7 million in 1977 compared to the comparable 1976 period. The improvement is principally due to an increase of \$1.4 million in income (principally dividends) received from foreign affiliates and a \$.5 million reduction in home office overhead. The 1976 amount includes a \$1.0 million loss relating to certain operations subsequently sold.

#### Income taxes

The effective tax rate for the year 1977 is expected to be higher than in 1976. As a result, the rate for the six months ended June 30, 1977 is 54% as compared to a 43% rate in 1976.

#### Comparison of results for the quarter ended June 30, 1977 with the quarter ended June 30, 1976

#### Sales

Total sales increased \$68.7 million or 32%.

The increase of \$43.7 million related to the manufacturing operations, includes \$22.3 million from the acquired Hammond operations. The balance of the improvement in sales of the manufacturing group is related to a continued trend since the beginning of the year of improved demand in pipe and tubing and metal products reflecting better economic conditions in the residential housing and general industrial markets. Selling prices were increased in the applicable operating units as the basic price of copper increased and some of these increases have been maintained despite

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a decline in copper prices in the latter portion of the quarter. Continued strong demand for automobiles and trucks resulted in another quarter of improved sales for the automotive products group.

Metal trading sales increased during the 1977 quarter because of physical deliveries being accelerated in anticipation of a copper mining strike as of June 30, 1977.

Coal mining sales increased due to higher volume in the domestic market and two sales price increases in November 1976 and April 1977 relating to a long-term foreign coal contract. Shipments to foreign markets were lower in the current period compared to the prior year.

Sales of the nonconsolidated real estate subsidiaries were \$13.9 million compared to \$12.0 million in the same period of 1976. Since these subsidiaries are accounted for on the equity method, their sales are excluded from consolidated amounts.

#### Income from continuing operations

Income from continuing operations before income taxes increased \$7.9 million or 41%.

The increase of \$1.8 million in manufacturing income includes \$.5 million from the acquired Hammond operations. Increases in the income of the pipe and tubing and metal products groups are due principally to improved pricing and increased sales volume. Automotive products group income increased due principally to higher sales volume. These increases are partially offset by lower income from the wire and cable operations which were impacted by a lower pricing trend which began in 1976 and was present until early in 1977. An improving trend in 1977 has not yet returned pricing to comparable 1976 levels.

Metal trading income improved principally because of reduced interest cost on borrowings incurred to finance inventories. There was also increased income from agency commissions and market action in 1977 that was favorable to arbitrage and hedged copper inventory positions.

The improvement in coal mining earnings reflects the higher domestic sales volume and a price increase in April 1977 on shipments to foreign markets.

The real estate subsidiaries incurred a \$1.0 million loss in 1977. Their loss for the 1976 period is excluded since it was charged to a reserve established in the purchase cost allocation.

Other-net improved \$2.0 million compared to the second quarter of 1976 due primarily to income of \$1.5 million (principally dividends) received from foreign affiliates and a non-recurring \$.6 million loss in 1976 relating to certain operations subsequently sold.

#### Income taxes

The effective tax rate for 1977 is 49% compared to a rate of 43% in 1976. The increase in the effective rate is due principally to the matters discussed in the comparison of the 1977 first and second quarter results.

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Part II - Other Information

Item 1. Legal Proceedings

See the discussion in Note 8 of Condensed Notes to the Condensed Consolidated Financial Statements in Part I of this Form 10-Q.

Item 7. Submission of Matters to a Vote of Security Holders

At The Annual Meeting of Stockholders on June 3, 1977:

(a) the following directors were elected:

Robert H. Cutler  
Robert C. Gluth  
Lewis B. Harder  
George A. Jones

G. Willing Pepper  
Jay A. Pritzker  
Robert A. Pritzker  
Alan Wolfley

(b) the stockholders adopted and approved an amendment to the Certificate of Incorporation to change the name of the Corporation to "The Marmon Group, Inc." There were 22,026,111 affirmative votes and 196,117 negative votes cast with respect to this matter.

Item 9(b). Exhibits and Reports on Form 8-K

No reports on Form 8-K were required to be filed for the three months ended June 30, 1977.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE MARMON GROUP, INC.  
Registrant

DATE: August 2, 1977

  
\_\_\_\_\_  
R. C. Gluth,  
Executive Vice President

DATE: August 2, 1977

  
\_\_\_\_\_  
T. L. Seifert  
Secretary

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